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2566
No. 12143

United States
Court of Appeals
for the Ninth Circuit

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax Court
of the United States

FILED

APR 4 - 1949

PAUL P. O'BRIEN,
CLERK

No. 12143

United States
Court of Appeals
for the Ninth Circuit

WALTS, INC.,

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

C. EARLE MEMORY, Esq.,
GEO. H. ZEUTZIUS, Esq.,
A. P. G. STEFFES, Esq.

For Respondent:

W. J. McFARLAND, Esq.

Docket No. 6974

WALTS, INC., a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transferred to Harlan J. 12/5/46.

DOCKET ENTRIES

1945

Jan. 23—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 23—Copy of Petition served on General Counsel.

Jan. 23—Notice of the appearance of C. Earle Memory as counsel filed.

Mar. 12—Answer filed by General Counsel.

1945

Mar. 12—Request for hearing in Los Angeles, California filed by General Counsel.

Mar. 15—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1946

Apr. 16—Hearing set June 10, 1946 at Los Angeles, Calif.

June 18—Hearing had before Judge Black on merits. Counsel for petitioner filed written motion to substitute attorneys and to file amendment to petition — respondent objects to latter motion. Motion granted. Copies served. Answer to amendment filed—copies served. Stipulation of facts filed. Petitioner's brief due August 5, 1946—respondent's September 5, 1946—petitioner's reply October 5, 1946.

July 8—Transcript of hearing of 6/18/46 filed.

Aug. 5—Brief filed by taxpayer with proof of service.

Sept. 5—Brief filed by General Counsel.

Oct. 3—Motion for extension to Oct. 30, 1946 to file reply brief filed by taxpayer. 10/3/46 granted.

Oct. 30—Order granting extension to Nov. 5, 1946 to file reply brief entered (Telegram).

Nov. 7—Reply brief filed by taxpayer. 11/8/46 copy served.

1947

- Jan. 17—Memorandum findings of fact and opinion rendered, Harlan J. Decision will be entered under Rule 50—copy served.
- Feb. 17—Motion for rehearing De Novo filed by taxpayer—Denied.
- Mar. 10—Respondent's computation for entry of decision filed.
- Mar. 13—Hearing set April 9, 1947 at Washington, D. C. under Rule 50.
- Apr. 9—Hearing had before Judge Harlan on settlement under Rule 50. Decision to be entered in accordance with respondent's computation.
- Apr. 10—Decision entered Harlan J. Div. 11.
- Apr. 18—Motion to correct decision filed by taxpayer. 4/21/47 denied.
- July 7—Petition for review by U. S. Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.
- July 8—Proof of service filed by taxpayer.
- Aug. 18—Copy of order for U. S. Court of Appeals, 9th Circuit extending time to December 15, 1947 to file record filed.
- Dec. 22—Certified copy of order from the 9th Circuit extending the time to February 1, 1948 to file record filed.

notice of deficiency is based upon the following errors:

(a) The commissioner proposes to disallow the directors' fees paid in the amount of \$1,000.00, and

(b) The commissioner proposes to disallow the compensation paid to two officers, W. J. Cunningham, President, and E. D. Morse, Secretary, in the amount of \$18,000.00 each.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

Directors' Fees

Petitioner contends that the directors' fees paid to four directors at \$250 each during the year were reasonable and fair, for services rendered, and are therefore deductible under Section 23(a) of the Internal Revenue Code. During the year 1942 there were 13 directors' meetings held, all of which were after regular business hours and many very vital decisions affecting the welfare of the petitioner came out of such meetings. The petitioner had a very difficult year in 1942 as a great many problems were encountered in obtaining materials and manpower in order for it to fulfill its part in the war production program.

Compensation of Officers

The petitioner is basing its contention that the compensation paid to the officers in the year 1942 was deductible under Section 23(a) of the Internal Revenue Code upon tests propounded by the Sec-

retary of Treasury before the Joint Committee on Internal Revenue Taxation where he stated in part, "The factors that will be considered in determining the reasonableness of such payments are the duties performed by the recipient, the character and amount of responsibility, the time devoted to the enterprise and the peculiar ability or special talent of the particular officer or employee . . ." These factors are discussed under the following headings:

Duties Performed by the Recipients. Mr. Cunningham functioned as the president of the petitioner and handled all of its relationship with its customers and vendors. Mr. Morse was the secretary of the petitioner and handled all financial and internal management and production of the petitioner. As they went through a very chaotic year in 1942 their respective duties overlapped and they oftentimes had to perform functions other than their own.

Character and Amount of Responsibility. Mr. Cunningham and Mr. Morse were jointly responsible for all of the activities of the petitioner including its plant construction, war production, manpower problems, obtaining of licensing agreements with the Aluminum Corporation of America, purchasing of materials, engineering, research, solving of problems encountered by the aircraft industry in their war production, etc.

Time Devoted to the Enterprise. Both Mr. Cunningham and Mr. Morse devoted full time to the

business of the petitioner and had no outside interests during the year 1942. Each of these officers averaged 80 hours per week during the year 1942 on the petitioner's business.

Peculiar Ability or Special Talent of the Particular Officer. Mr. Cunningham is 46 years of age and has been a very successful business man for a great many years. He asserts, and the petitioner believes, that he has had an annual income in varying amounts in excess of \$25,000.00 for 14 of the years preceeding his formation of the petitioner. Mr. Morse is 48 years of age and has been a very successful business man for a great many years. The petitioner believes that he has had an annual income in varying amounts in excess of \$25,000.00 for many of the years preceeding his connection with the petitioner, but as Mr. Morse is no longer connected with the petitioner, no more definite information is available to petitioner. Mr. Cunningham organized the petitioner on April 24, 1940 and Mr. Morse joined the petitioner in February, 1941, and during 1940 and 1941 no salaries were drawn as the business was just getting started. The total sales for the year 1941 approximated \$40,000 and resulted in adjusted net income of \$2,339.50. The total sales for the year 1942 approximated \$434,000, resulting in net income of approximately \$30,000 (after deducting \$56,000 officers' salaries) upon which the petitioner paid federal taxes of approximately \$23,000. After allowing for the salaries paid, the petitioner earned 350% on its invested capital and paid federal taxes of 77%

thereof for the year 1942. Total sales for the year 1943 approximated \$964,000 resulting in net income of approximately \$152,000 (after deducting \$78,000 officers' salaries) upon which petitioner paid federal taxes of approximately \$77,000 and refunded to the government on renegotiation approximately \$56,000. The petitioner thus earned 1,388% on its invested capital for 1943 and paid to the government 88% thereof. It is quite obvious to the petitioner that these earnings were possible only because of the personal efforts expended by the two officers in question in building up the petitioner's facilities to handle an increase in volume from \$40,000 in 1941 to 10 times that in 1942 and 24 times that in 1943 without government financing. In three years these officers have built the petitioner's business up to what it is today, believed by the petitioner to be the fourth largest aluminum foundry on the Pacific Coast.

The petitioner contends that the compensation paid to its officers does not reduce the net earnings subject to tax below that of competing concerns that secured the services of officers and employees by open bargaining. The petitioner further contends that the substantial earnings of 350% on invested capital during 1942, while in part due to the urgent need for the petitioner's products in the war production program, was made possible only by the concerted efforts, skills, talents and peculiar abilities of Mr. Cunningham and Mr. Morse.

Wherefore, the petitioner prays that this Court may hear the proceeding and find that no additional excess profits taxes and/or declared value excess profits taxes are due from the petitioner for the taxable year ended December 31, 1942.

/s/ W. J. CUNNINGHAM,
President for the Petitioner, Walts, Inc., Petitioner, 5511 Boyle Avenue, Los Angeles 11, Calif.,
Counsel, C. Earle Memory.

State of California,
County of Los Angeles—ss.

W. J. Cunningham, being duly sworn, says that he is the president of Walts, Inc., a corporation, the above-named petitioner; that he is duly authorized to verify the foregoing petition; that he has read same and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief and that those he believes to be true.

/s/ W. J. CUNNINGHAM.

Subscribed and sworn to before me this 18th day of January, 1945.

(Seal) /s/ ELINOR C. MEMORY,
Notary Public in and for the County of Los Angeles, State of California.

EXHIBIT "A"

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of Internal Revenue Agent in Charge, Los Angeles Division, LA:IT:90D:PAK.

Oct. 27, 1944

Walts, Inc.
5511 Boyle Avenue
Los Angeles 11, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1941 and December 31, 1942 discloses an overassessment of \$518.62, that the determination of your declared value excess profits tax liability for the taxable year ended December 31, 1942 discloses a deficiency of \$1,021.20, and that the determination of your excess profits tax liability for the taxable year ended December 31, 1942 discloses a deficiency of \$28,690.00, as shown in the statement attached.

In accordance with the provisions of existing Internal Revenue Laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washing-

ton, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

Enclosures: Statement, Form of Waiver, Form 843.

Exhibit A—(Continued)

Statement

Tax Liability for the Taxable Years Ended

December 31, 1941 and 1942

Income Tax

Year	Liability	Assessed	Overassessment
1941	\$ 253.25	\$ 641.32	\$388.07
1942	1,373.93	1,504.48	130.55
	<hr/>	<hr/>	<hr/>
	\$1,627.18	\$2,145.80	\$518.62

Declared Value Excess-Profits Tax

Year	Liability	Assessed	Deficiency
1942	\$1,021.20	\$ None	\$1,021.20

Excess Profits Tax

Year	Liability	Assessed	Deficiency
1942	\$50,187.27	\$21,497.27	\$28,690.00

In making this determination of your tax liability, careful consideration has been given to the report of examination dated June 24, 1944, to your protest dated August 16, 1944, and to the statements made at the conference held on August 30, 1944.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the Collector of Internal Revenue for your district, and will be applied by that official in accordance with Section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent

Exhibit A—(Continued)

overassessments by filing with the Collector of Internal Revenue for your district claims for refund on Form 843, copies of which are enclosed, the bases of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Mr. Claude I. Parker, 808 Bank of America Building, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income
Taxable Year Ended December 31, 1941

Net income as disclosed by return.....		\$3,053.93
Unallowable deductions:		
(a) Other deductions decreased	\$ 22,40	
(b) Franchise taxes decreased	127.25	149.65
Total		\$3,203.58
Additional deductions:		
(c) Additional depreciation allowed.....	\$ 249.08	
(d) Capital stock tax allowed.....	625.00	
(e) Net operating loss carryover from 1940	1,123.58	1,997.66
Net income adjusted		\$1,205.92

Explanation of Adjustments

(a) The deduction claimed under Other Deductions for office supplies is overstated \$22.40.

(b) The deduction claimed for franchise taxes in the amount of \$152.25 is decreased to \$25.00, the amount allowable under Section 23(c) of the Internal Revenue Code.

Exhibit A—(Continued)

(c) An additional deduction for depreciation is allowed in the amount of \$249.08.

(d) A deduction for capital stock taxes is allowed in the amount of \$625.00.

(e) A deduction is allowed for a net operating loss carryover from 1940 in the amount of \$1,123.58.

Computation of Income Tax

Taxable Year Ended December 31, 1941

Net income adjusted	\$1,205.92
Income Tax:	
Normal Tax: 15% of \$1,205.92.....	\$180.89
Surtax: 6% of \$1,205.92	72.36
Correct Income Tax Liability.....	\$ 253.25
Income Tax Assessed: Original Account No. 411762.....	641.32
Overassessment of Income Tax.....	\$ 388.07

Adjustments to Net Income

Taxable Year Ended December 31, 1942

Net income as disclosed by return.....	\$29,828.39
Unallowable Deductions:	
(a) Excessive depreciation disallowed.....	\$ 898.22
(b) Compensation of officers disallowed....	36,000.00
(c) Directors' fees disallowed	1,000.00 37,898.22
Total	\$67,726.61
Additional deductions:	
(d) Additional capital stock taxes allowed	\$ 2,187.50
(e) Additional franchise taxes allowed.....	66.41 2,253.91
Net income adjusted	\$65,472.70

Exhibit A—(Continued)

Explanation of Adjustments

(a) The deduction for depreciation claimed in your return is \$898.22 in excess of the amount allowable under Section 23(a) of the Internal Revenue Code.

(b) It is determined, under the provisions of Section 23(a)(1) of the Internal Revenue Code, that the deductions claimed for compensation of certain of your officers are in excess of a reasonable compensation for services rendered by said officers as shown in the following:

Name and Title	Amount Claimed	Reasonable Compensation	Excessive Amount
W. J. Cunningham, Pres.	\$28,000.00	\$10,000.00	\$18,000.00
E. D. Morse, Secty.	28,000.00	10,000.00	18,000.00
Total	\$56,000.00	\$20,000.00	\$36,000.00

The excessive amount of \$36,000.00 is disallowed as a deduction.

(c) The deduction claimed for directors' fees in the amount of \$1,000.00 (included in the deduction claimed for salaries and wages) is disallowed.

(d) An additional deduction for capital stock taxes is allowed in the amount of \$2,187.50.

(e) An additional deduction is allowed for franchise taxes in the amount of \$66.41.

Exhibit A—(Continued)

Computation of Declared Value Excess-Profits Tax
Taxable Year Ended December 31, 1942

Net income adjusted	\$65,472.70
Less: 10% of \$500,000.00 value of capital stock as de- clared in the capital stock tax return for the year ended June 30, 1942	50,000.00
	<hr/>
Net income subject to declared value excess-profits tax....	\$15,472.70
Declared value excess-profits tax:	
6.6% of \$15,472.70	\$1,021.20
Correct declared value excess-profits tax liability.....	\$ 1,021.20
	<hr/>
Declared value excess-profits tax assessed:	
Original, Account No. 1437761.....	None
	<hr/>
Deficiency of declared value excess-profits tax.....	\$ 1,021.20

Computation of Excess Profits Net Income
Taxable Year Ended December 31, 1942

Excess profits net income as disclosed by return.....	\$20,054.72
Additions:	
(a) Excessive depreciation disallowed	\$ 898.22
(b) Compensation of officers and directors disallowed	37,000.00
	<hr/>
	37,898.22
Total	\$67,952.94
Reductions:	
(c) Additional capital stock taxes allowed..	\$2,187.50
(d) Additional franchise tax allowed.....	66.41
(e) Additional declared value excess-profits tax allowed	1,021.20
	<hr/>
	3,275.11
Excess profits net income adjusted.....	\$64,677.83

Exhibit A—(Continued)

Explanation of Adjustments

(a), (b), (c) and (d). These adjustments are the same as those made to net income and previously explained.

(e) A deduction is allowed for declared value excess-profits tax in the amount of the deficiency thereof as shown above in the computation of declared value excess-profits tax.

Adjustments to Invested Capital

Taxable Year Ended December 31, 1942

Invested capital as disclosed by return.....		\$7,406.96
Additions:		
(a) Accumulated earnings at January 1, 1942,		
understated	\$891.81	
(b) Average borrowed invested capital		
understated	267.80	1,159.61
		<hr/>
Invested capital adjusted		\$8,566.57

Explanation of Adjustments

(a) Amount of accumulated earnings determined.....	\$	930.27
Amount reported (line 4, Schedule C of return).....		38.46
		<hr/>
Additional amount allowed	\$	891.81
(b) Average borrowed capital determined.....	\$11,272.60	
Average borrowed capital reported.....	10,736.99	
		<hr/>
Increase	\$	535.61
50% of increase	\$	267.80

Computation of Excess Profits Credit

Taxable Year Ended December 31, 1942

Invested capital	\$8,566.57
8% of invested capital.....	\$ 685.33
Excess profits credit	\$ 685.33

Exhibit A—(Continued)

Computation of Adjusted Excess Profits Net Income
Taxable Year Ended December 31, 1942

Excess Profits Net Income.....		\$64,677.83
Less: Exemption	\$5,000.00	
Excess profits credit	685.33	5,685.33
		<hr/>
Adjusted excess profits net income.....		\$58,992.50

Computation of Excess Profits Tax
Taxable Year Ended December 31, 1942

Tax under Section 710(a) (1) (A) I.R.C.		
1. Adjusted excess profits net income.....		\$58,992.50
2. Excess profits tax (90% of \$58,992.50).....		\$53,093.25
Tax under Section 710(a) (1) (B) I.R.C.		
3. Net income		\$65,472.70
4. Less: Declared value excess-profits tax.....		1,021.20
		<hr/>
5. Surtax net income computed without the credit for in- come subject to excess profits tax.....		\$64,451.50
6. 80% of Item 5		\$51,561.20
7. Income tax as computed below.....		1,373.93
		<hr/>
8. Excess of Item 6 over Item 7.....		\$50,187.27
Tax under Section 710(a), I.R.C.		
9. Excess profits tax, lesser of Items 2 and 8.....		\$50,187.27
10. Correct excess profits tax liability.....		\$50,187.27
11. Excess profits tax assessed:		
Original, Account No. 1437839		\$21,497.27
		<hr/>
12. Deficiency of excess profits tax.....		\$28,690.00

Computation of Income Tax
Taxable Year Ended December 31, 1942

Net income		\$65,472.70
Less: Declared value excess-profits tax.....	\$1,021.20	
Income subject to excess profits tax....	58,992.50	60,013.70
		<hr/>

Exhibit A—(Continued)

Normal tax net income.....	\$ 5,459.00
Surtax net income	\$ 5,459.00
Income Tax:	
Normal Tax:	
15% of \$5,000.00	\$ 750.00
17% of \$ 459.00	\$ 78.03

Total	\$ 828.03
Surtax:	
10% of \$5,459.00	545.90

Total income tax	\$ 1,373.93
Correct income tax liability.....	\$ 1,373.93
Income Tax Assessed:	
Original, Account No. 1437761.....	\$ 1,504.48

Overassessment of income tax.....	\$ 130.55

[Endorsed]: T.C.U.S. Filed Jan. 23, 1945.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are declared value excess profits tax and excess profits tax for the year 1942.

4(a)(b). Denies the allegations contained in subparagraphs (a) and (b) of paragraph 4 of the petition.

5. Denies the allegations of facts, contentions and arguments in paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,

B. M. COON,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Mar. 12, 1945.

[Title of Tax Court and Cause.]

AMENDMENT TO PETITION

Walts, Inc., by George H. Zeutzius and A. P. G. Steffes, its counsel, with leave of Court first had and obtained, amends its petition filed herein as follows:

Add the following subparagraph to paragraph numbered 4:

(c) The Commissioner of Internal Revenue exceeded his jurisdiction, powers and authority in assuming visitatorial power over the salary pay-

ments through the medium of a disallowance of part of the payments actually made by petitioner to Messrs. Cunningham and Morse during 1942 in the aggregate sum of \$56,000.00.

Insert the following subparagraph immediately after the first sentence of paragraph numbered 5:

(a) Section 23(a)(1)(A) of the Internal Revenue Code allows the deduction of all ordinary and necessary business expenses. Directors' fees aggregating \$1,000.00 were actually paid by petitioner to four of its directors for their attendance and services at directors' meetings during 1942. All such fees were paid pursuant to proper corporate authority and resolutions therefor, were in their entirety ordinary and necessary business expenses of petitioner for 1942, and were proper and lawful deductions. If this contention be denied, petitioner contends that the fees and salaries involved were allowable for the following reasons:

Add the following paragraph at the end of paragraph numbered 5:

(c) Section 23(a)(1)(A) of the Internal Revenue Code allows the deduction of all ordinary and necessary business expenses. Salaries of \$28,000.00 each were actually paid by petitioner to W. J. Cunningham and E. D. Morse during 1942 as compensation for services rendered by them and said amounts were in their entirety ordinary and necessary expenses incurred and paid by petitioner in the conduct of its business operations.

Substitute the following paragraph for the prayer contained in the petition as heretofore filed:

Wherefore, petitioner prays that this Court may

hear the proceeding, find that no additional excess profits taxes or declared value excess profits taxes are due from petitioner for the taxable calendar year 1942; that the Commissioner acted without authority in undertaking to disallow the directors' fees of \$1,000.00 and \$36,000.00 of the salaries paid; and for such other further and general relief as to the Court may seem meet and proper.

/s/ GEORGE H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Filed June 18, 1946.

[Title of Tax Court and Cause.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amendment to petition of the above-named taxpayer, admits and denies as follows:

4(c) Denies the allegations contained in subparagraph (c) of paragraph 4 of the amendment to petition.

5(a) Denies the allegations contained in subparagraph (a) of paragraph 5 of the amendment to petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the amendment to petition.

6. Denies each and every allegation contained in the amendment to petition.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

EARL C. CROUTER,

W. J. McFARLAND,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed June 18, 1946.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts should be taken as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith; and each party reserves the right to object to any part of the stipulated facts on any and all grounds he or it may deem proper:

1. Petitioner, *Walts, Inc.*, known also by the fictitious trade name of *Aero Alloys*, was incorporated under the laws of California on April 24, 1940, with an authorized capital stock of \$25,000.00,

divided into 2,500 shares of a par value of \$10.00 per share. Its principal office and place of business is 5511 Boyle Avenue, Los Angeles 11, California.

2. Petitioner's Articles of Incorporation were executed April 22, 1940, by Walter E. Withers, Walter J. Cunningham and J. Robert Muratta, all of Los Angeles, California. By its Articles, which named the three incorporators as its first directors, petitioner was and is authorized, among other things, as follows:

To own, operate, maintain, manage, equip, improve, repair, alter and otherwise deal with, use and enjoy, to invent, design, develop, assemble, build, construct, fabricate, manufacture, buy, import, lease as lessee and otherwise acquire, to mortgage, deed in trust, pledge and otherwise encumber, and to sell, export, lease as lessor, and otherwise dispose of goods, wares, merchandise and personal property of every sort, nature and description.

3. Petitioner's organization meeting was held by its directors, Messrs. Withers, Cunningham and Muratta, on April 25, 1940. Withers was elected president, Muratta was elected vice-president, and Cunningham secretary and treasurer. At this meeting the directors adopted the following resolutions, among others:

Resolved: That whereas, it is deemed to the best interests of this corporation that Fifty (50) Shares of its Common Stock of the par value of Ten (\$10.00) Dollars per share be issued to Walter E. Withers for an assignment and transfer to the corporation of all his right, title and interest in and to the Foundry Equipment, an inventory of

which is attached hereto; and the assets so transferred is of the fair value of \$600.00;

And, whereas, it is deemed to be to the best interests of this corporation that One Hundred (100) Shares of its Common Stock, of the par value of Ten (\$10.00) Dollars per share, be issued and sold:

Fifty (50) Shares to Walter E. Withers.

Fifty (50) Shares to Katharyn S. Cunningham.

Resolved: That the officers of this corporation shall not be entitled to any compensation for any services that might be rendered and that the said corporation shall not employ any person or persons, or incur any liability whatsoever for salaries.

By resolution the president was authorized to enter into an agreement with John and Alex Ruzzamenti for the purpose of putting to use the foundry equipment to be assigned to the corporation by Walter E. Withers and of obtaining production of ornamental fixtures of all kinds and description for sale and distribution.

4. On May 9, 1940, the California Commissioner of Corporations authorized petitioner to issue and sell not to exceed fifty (50) of its shares as consideration for the personal property of Withers (consisting of foundry equipment and supplies) which was first to be transferred and assigned to petitioner free and clear of liens and encumbrances; also to sell and issue to Walter E. Withers and Katharyn S. Cunningham (wife of Walter J. Cunningham), or either of them, an aggregate not to exceed One Hundred (100) of petitioner's shares at par for cash.

5. Walter E. Withers executed a bill of sale to petitioner of his foundry equipment and supplies and a double-end grinder then located at 1170 East Slausson Avenue, Los Angeles, in consideration for the issuance to him of Fifty (50) shares of petitioner's stock. On May 15, 1940, petitioner issued fifty (50) shares of its stock to Withers for said foundry personal property. On the same day an additional fifty (50) shares were issued to Withers for Five Hundred (\$500.00) Dollars in cash. Fifty (50) shares were also issued on May 15th to Katharyn S. Cunningham for cash. At all times between May 15, 1940, and December 31, 1942, inclusive, petitioner's issued and outstanding capital stock consisted of \$1,500.00. During 1940 petitioner's outstanding shares were owned, One Hundred by Withers and Fifty by Katharyn S. Cunningham, wife of Walter J. Cunningham. On March 31, 1941, Withers surrendered his certificates for one hundred shares of stock and there was issued in lieu thereof seventy-five (75) shares on March 31, 1941, to E. D. Morse, and twenty-five (25) shares to Katharyn S. Cunningham. From March 31, 1941, through December 31, 1942, petitioner's outstanding stock was owned, seventy-five (75) shares by E. D. Morse and seventy-five (75) shares by Katharyn S. Cunningham.

6. By two separate written agreements dated February 26, 1941, between the Aluminum Company of America, a Pennsylvania corporation, and petitioner, the former as owner of four patented processes for the thermal treatment of casting of alloy compositions, licensed petitioner to use the

same in the factories and shops of petitioner in the United States in consideration for payment of a royalty of one-half cent per pound on all articles produced by petitioner with the use of such processes. By letter dated August 28, 1942, the Aluminum Company of America granted petitioner the right to the use of said processes royalty free from July 1, 1942, until the cessation of hostilities "because of the direct relationship of the heat treatment of aluminum alloy castings to wartime production". Attached hereto and marked Exhibit "1-A" hereof are photostat copies of the above mentioned written agreements dated February 26, 1941, together with a letter dated August 28, 1942, addressed to the petitioner from the Aluminum Company of America.

7. Under date of March 31, 1941, the petitioner's directors authorized and directed petitioner to lease or build and construct an adequate plant and purchase and install equipment to maintain said plant and to do all things necessary to diligently and efficiently establish a plant for the manufacture of aluminum alloys products. For the purpose of obtaining needed funds with which to set up and operate a foundry for the manufacture of sand cast aluminum parts, the then foundry being unsuitable, the directors at their meeting of March 31, 1941, adopted a resolution authorizing the borrowing of \$8,500.00 for the benefit of petitioner from D. M. Morse and to give petitioner's obligation in evidence thereof, said sum to be repaid as soon as sufficient reserves were available. On March 28, 1941, Muratta resigned as a director and vice-pres-

ident and E. D. Morse was appointed a director in his place.

8. By resolution adopted March 28, 1941, petitioner's directors authorized the hiring of employees and the payment of salaries for their services. Pursuant thereto one George E. Schultz was appointed general manager, but never performed any services in that capacity. The board authorized, on March 31, 1941, the payment of salaries of \$200.00 per month to Walter J. Cunningham and \$200.00 per month to E. D. Morse for their services until such time as the directors should determine otherwise. Withers also resigned as a director and president of the corporation on March 31, 1941, and Walter J. Cunningham was appointed president, E. D. Morse secretary-treasurer and director, and George E. Schultz vice-president and director.

9. On July 14, 1941, petitioner's directors authorized the borrowing of Two Thousand (\$2,000.00) Dollars from the Bank of America at Long Beach, to be used for paying outstanding bills and to be repaid to the bank out of monies due petitioner on accounts receivable from the Douglas Aircraft Corporation of Santa Monica, which accounts were payable to petitioner on August 10, 1941. Said resolution was adopted to secure the endorsement of E. D. Morse on the note to the bank for said loan.

10. On October 31, 1941, petitioner's directors adopted a resolution to amend its Articles of Incorporation to provide for four directors instead of three. The necessary steps to amend the Articles were promptly taken.

11. At the annual stockholders' meeting of petitioner on January 5, 1942, the following directors were elected: Walter J. Cunningham, Mrs. Kathryn S. Cunningham, Mrs. Dorothy M. Morse, Elmer D. Morse.

The directors, immediately following the stockholders' meeting, elected said persons president, vice-president, vice-president and secretary-treasurer respectively. At their meeting of January 5, 1942, the foregoing directors adopted resolutions reading as follows:

Resolved: that, notwithstanding any action heretofore taken by the Board of Directors, by resolution or otherwise, that the President, Walter J. Cunningham, be paid at the rate of Twenty-four Thousand Dollars (\$24,000.00) per year for his services, and that the Secretary and Treasurer, E. D. Morse, be paid at the rate of Twenty-four Thousand Dollars (\$24,000.00) per year for his services; and

Be It Further Resolved: that the respective salaries of said Walter J. Cunningham and E. D. Morse, be, and the same hereby are, effective as of and from January 1, 1942, and that same be paid in such installments, monthly or otherwise, as the officers may from time to time elect.

Be It Further Resolved: that it is the intent hereby to revoke any action heretofore taken by the Board of Directors in regard to the respective salaries of said officers.

12. At a meeting held April 10, 1942, petitioner's directors authorized the purchase and installation of a new heat treating furnace at the

cost of approximately \$5,000.00 and the erection of an addition to petitioner's plant, together with necessary equipment, to cost approximately \$3,000.

13. On June 12, 1942, petitioner's directors authorized its president and treasurer to erect an additional building on the north side of petitioner's plant and to purchase necessary equipment at an expenditure of approximately \$2,500.00.

14. At a meeting held August 14, 1942, petitioner's directors adopted a motion "that each director be paid the sum of \$25.00 for attendance at each meeting of the board of directors".

15. At a meeting held August 28, 1942, petitioner's directors adopted resolutions increasing salaries of its president Walter J. Cunningham and its secretary-treasurer E. D. Morse to \$36,000.00 each per year for his services, said salaries to be effective as of September 1, 1942. The minutes stated in part as follows:

The president stated that the increased business of the corporation, and its many new developments, has increased the burdens and the responsibilities and time necessary for the officers to devote to the business of the corporation; therefore,

On motion duly made, seconded and unanimously carried, the following resolution was adopted:

Resolved: that notwithstanding any action heretofore taken by the Board of Directors, by resolution or otherwise, that the President, Walter J. Cunningham, be paid at the rate of Thirty-six

Thousand Dollars (\$36,000.00) per year for his services, and that the Secretary and Treasurer, E. D. Morse, be paid at the rate of Thirty-six Thousand Dollars (\$36,000.00) per year for his services; and

Be It Further Resolved: that the respective salaries of said Walter J. Cunningham and E. D. Morse, be and same hereby are, effective as of and from September 1, 1942, and that same be paid in such installments, monthly or otherwise, as the officers may from time to time elect.

16. At a meeting held September 15, 1942, the minutes recorded were in part as follows:

The President stated that the increased demands upon the business of the corporation made it necessary to consider erection of building and acquiring equipment.

On motion duly made, seconded and unanimously carried the President and Secretary of the corporation were authorized and directed to effect the construction of a new building on premises leased from the American Mineral Company and to obtain necessary equipment for said building, all at a cost of approximately \$9,000.00.

17. During the period August 28, 1942, to December 30, 1942, inclusive, ten recorded directors' meetings were held at which all four directors were present. The discussions in the meetings dealt chiefly with reports on the increase of the business, bank loans, the construction of additions to petitioner's plant, the purchase of necessary additional

equipment, the authorization thereof, and of other expenditures; also that arrangements had been completed for a line of credit with the Bank of America up to Twenty-five Thousand (\$25,000.00) Dollars.

18. During 1942, petitioner's business consisted entirely of the manufacture and sale of airplane parts as a sub-contractor for airplane parts used by aircraft corporations engaged in war work, which said parts were made of aluminum by use of the heating processes covered by the licensing agreements with the Aluminum Company of America.

19. Petitioner's gross sales in 1940 were \$1,227.38, and it sustained an operating loss for the year ending December 31, 1940, in the amount of \$1,123.58. No salaries were paid by petitioner to any of its officers or directors during 1940. During 1941 petitioner's gross sales amounted to \$39,996.19, and respondent determined that petitioner had an adjusted net taxable income of \$1,205.92. During 1941 it paid salaries to its officers aggregating \$3,300.00, of which \$1,650.00 was paid to its president, Walter J. Cunningham, and \$1,650.00 to its secretary, E. D. Morse, both of whom devoted their entire time to petitioner's business and operations. During the calendar year 1942 petitioner's gross sales amounted to \$434,363.44, and its net profit before payment of salaries to its officers amounted to \$85,828.39. During 1942 petitioner paid officers' salaries aggregating \$56,000.00, of which \$28,000.00 was paid to its president, Walter J. Cunningham, and \$28,000.00 to its secretary,

E. D. Morse, both of whom devoted their full time to the business and operations of petitioner. In addition, each of the four directors was paid \$250.00 during 1942 for attendance and services at directors' meetings, being at the rate of \$25.00 per meeting per director for ten of the directors' meetings held during 1942.

No dividends were paid by petitioner at any time during the period April 24, 1941, to December 31, 1942, inclusive.

20. Petitioner kept its books and filed its income and profits tax returns on the accrual and calendar year basis. It filed its income and declared-value excess profits tax returns and excess profits tax returns with the Collector of Internal Revenue for the Sixth Collection District of California at Los Angeles.

21. The Commissioner determined that petitioner had overpaid its 1942 income taxes in the amount of \$130.55, that there was a deficiency of \$1,021.20 in petitioner's 1942 declared-value excess profits tax and a deficiency of \$28,690.00 in petitioner's 1942 excess profits tax. In arriving at said deficiency determination, the Commissioner disallowed \$36,000.00 of the total amount of \$56,000.00 paid equally to Messrs. Cunningham and Morse during 1942 and claimed as a compensation deduction by petitioner for the taxable year 1942. The Commissioner also disallowed \$1,000.00 claimed by the petitioner to have been paid as directors' fees during 1942 to the four directors as follows:

\$250.00 to Walter J. Cunningham;

\$250.00 to E. D. Morse;

\$250.00 to Katharyn S. Cunningham, and

\$250.00 to Dorothy M. Morse.

22. True copies of petitioner's balance sheets and profit and loss statements for the years 1941 and 1942, marked Exhibits "2-B", "3-C", "4-D" and "5-E", are attached hereto and by reference made a part hereof.

23. True copies, per books, of petitioner's notes payable, sales and earned surplus accounts, and of the W. J. Cunningham drawing account are attached hereto, marked Exhibits "6-F", "7-G", "8-H" and "9-I", and by reference made a part hereof. The drawing account for E. D. Morse for the period shown in Exhibit "9-I" is identical in all respects with said Exhibit "9-I". As of December 31, 1942, petitioner's books reflect the entry of a credit of \$500.00 in an account entitled "Paid In Surplus".

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES (by G.H.Z.)
Counsel for Petitioner.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

* * * *

EXHIBIT 2-B

WALTS INC. d/b/a AERO ALLOYS INC.

BALANCE SHEET—DECEMBER 31, 1941

Assets:

Cash	\$ 1,450.98
Notes and Accounts Receivable.....	6,749.13
Inventories:	
Raw Material	\$ 750.00
Finished Goods	2,500.00
Supplies	550.00
	<hr/>
	3,800.00
Depreciable Assets	\$9,638.13
Less: Reserve for Depreciation and Amortization	796.45
	<hr/>
	8,841.68
Other Assets:	
Deposits	\$ 253.90
Organization Expense	159.00
	<hr/>
	412.90
	<hr/>
Total Assets	\$21,254.69
	<hr/>

Liabilities:

Accounts Payable	\$ 4,987.45
Notes Payable	12,000.00
Accrued Payroll	534.00

Other Liabilities:

Accrued Social Security Taxes.....	\$1,372.06
Federal Income and Excess Profits Tax.....	10.22
Federal Capital Stock Tax (1941)	312.50
	<hr/>
	\$ 1,694.78
Capital Stock—(Common)	1,500.00
Paid-in Surplus	500.00
Earned Surplus	38.46
	<hr/>
Total Liabilities and Net Worth.....	\$21,254.69
	<hr/>

EXHIBIT 3-C

WALTS INC. d/b/a AERO ALLOYS INC.

PROFIT AND LOSS STATEMENT—DECEMBER 31, 1941

Sales		\$39,996.19
Cost of Sales:		
Purchases	\$ 9,612.56	
Salaries and Wages	22,725.89	
Other Costs	2,723.48	
	<u> </u>	
	\$35,061.93	
Less: Inventory 12/31/41.....	3,800.00	
	<u> </u>	
		31,261.93
		<u> </u>
Gross Profit.....		\$ 8,734.26
Expenses:		
Compensation Officers	\$ 3,300.00	
Rent	480.00	
Interest	44.42	
Taxes	546.34	
Depreciation	596.45	
Bank Charges	10.06	
Entertainment	48.20	
Royalties	30.07	
Towels	4.35	
Freight and Express	53.89	
Insurance	98.40	
Utilities	58.92	
Office Supplies	257.22	
Telephone	129.33	
Auto and Delivery Expense.....	52.39	
Advertising	30.00	
Permit	16.00	
Legal and Audit	354.00	
Formula Writeoff	1,140.00	
	<u> </u>	
		\$ 7,250.04
		<u> </u>
Net Profit.....		\$ 1,484.22
		<u> </u>

EXHIBIT 4-D

WALTS INC. d/b/a AERO ALLOYS INC.

PROFIT AND LOSS STATEMENT—DECEMBER 31, 1942

Sales		\$434,363.44
Cost of Sales:		
Raw materials, beginning inventory.....	\$ 750.00	
Purchases	76,541.49	
		<hr/>
	\$ 77,291.49	
Closing Inventory	7,280.35	
		<hr/>
Cost of Raw Materials.....	\$ 70,011.14	
Direct Labor	209,770.67	
Depreciation	3,313.19	
Freight and Express	383.22	
*Supplies	2,383.43	
Group Insurance	413.60	
Sacks and Boxes	1,117.53	
Small Tools	1,902.02	
Gates and Risers	79.91	
Core Oil	834.58	
Sand	1,871.41	
Crucibles	10,145.03	
Gas and Power	5,287.90	
Shop Supplies	1,242.89	
Sand Blast	7,294.63	
Laboratory and X-Ray	2,461.61	
Repairs	4,173.02	
Compensation Insurance	5,240.48	
Pay Roll Taxes	8,412.02	
Patterns	515.90	
Miscellaneous Expense	243.99	
		<hr/>
	\$337,098.17	
Beginning Inventory, Finished Goods....	2,500.00	
		<hr/>
	\$339,598.17	
Closing Inventory, Finished Goods.....	10,434.20	
		<hr/>
		\$329,163.97
		<hr/>
Gross Profit.....		\$105,199.47

Exhibit 4-D—(Continued)

Expenses:

Executive Salaries	\$ 56,000.00	
Office Salaries	3,326.30	
Rent	1,700.00	
Entertainment	2,792.75	
Office Supplies and Stationery.....	1,253.22	
Telephone and Telegraph	431.30	
Taxes and Licenses	982.35	
Payroll Taxes	365.72	
Legal and Accounting Service.....	1,893.25	
Auto Travel	2,574.81	
Utilities	110.74	
Repairs	660.73	
Royalties	438.53	
Insurance	982.58	
Interest	464.65	
Directors' Fees	1,000.00	
Freight and Express	162.71	
Subscriptions and Dues	31.00	
Advertising	31.44	
Miscellaneous	169.02	
		\$ 75,371.08
		<hr/>
Net Profit.....		\$ 29,828.39

* Supplies Inventory 1/1/42	\$ 550.00	
Supplies Purchased	2,333.43	
		<hr/>
		\$2,883.43
Less: Supplies Inv. 12/31/42.....	500.00	
		<hr/>
Supplies Used	\$2,383.43	

EXHIBIT 5-E

WALTS INC. d/b/a AERO ALLOYS INC.

BALANCE SHEET—DECEMBER 31, 1942

Assets:

Cash	\$ 9,406.51	
Notes and Accounts Receivable.....		39,246.36
Inventories:		
Raw Material	\$ 7,280.35	
Finished Goods	10,434.20	
Supplies	500.00	
		<u>18,214.55</u>
Depreciable Assets	\$34,747.98	
Less: Reserve for Depreciation and Amortization	4,109.64	
		<u>30,638.34</u>
Other Assets:		
Deposits	\$ 123.90	
Organization Expense	159.00	
Prepaid Insurance	2,151.92	
Post War Excess Profits Tax Credit.....	2,149.73	
Tax Refund Claims (State).....	239.76	
Tax Refund Claims (Federal).....	631.10	
		<u>5,455.41</u>
Total Assets.....		<u>\$102,961.17</u>

Liabilities:

Accounts Payable	\$ 28,812.07	
Notes Payable		33,500.00
Other Liabilities:		
Accrued Social Security Taxes.....	\$ 5,484.61	
Federal Income and Excess Profits Tax	23,001.75	
Accrued Compensation Insurance.....	559.75	
Employees' Defense Bonds	588.16	
		<u>29,634.27</u>
Capital Stock (Common)		1,500.00
Paid-in Surplus		500.00
Earned Surplus		9,014.83
Total Liabilities and Net Worth.....		<u>\$102,961.17</u>

EXHIBIT 6-F

NAME *Mater Payable*
 ADDRESS

CREDIT
 LIST

LINE NO.	DESCRIPTION	DATE	CHARGE	CREDIT	BALANCE
10	D. W. Moss	9		850000	
11	K. S. Cunningham	"		114000	
12	Bank of America	"	114000		750000
13	Bank of America	9		200000	1050000
14	K. D. Morris	9	100000	100000	
15	Bank of America	"		350000	
16	"	"	200000		1200000
17	K. D. Morris	9	100000		1100000
18	Bank of America	9	350000		750000
19	Adj. not in chg. - 3/31	9		100000	850000
20	Bank of America	9		7500000	3350000
21	Bank of America	CD 191	200000		3150000
22	"	CD 209	200000		2950000
23	"	163	200000		2750000
24	"	174	200000		2550000
25	"	115	200000		2350000
26	"	141	200000		2150000
27	Bank of America	204		2500000	
28	Bank of America 13100 - D. W. Moss 8500	207	2150000		2500000
29	Bank of America	770	400000		2100000
30	"	737	400000		1700000
31	"	245	400000		1300000
32	"	273	400000		900000
33	Bank of America	287	400000		500000
34	"	307	500000		0

EXHIBIT 7-G

SHEET NO.
CREDIT RATING

CREDIT LIMIT

NAME *Salvo*
ADDRESS

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
Aug 31		77	75 08	7783 95	7708 87
Sept 30		83	58 05	3148 24	10357 09
Oct 31		85	138 77	6065 77	
Nov 30		77	147 55	10711 40	26789 91
Dec 31		15	496 54	13707 82	39996 19
"	P. & L.	16	39996 19		0
1942					
Jan 31		77	466 19	14448 57	11984 38
Feb 28		78	861 96	14201 55	25321 67
Mar 31		76	491 78	17675 80	42455 69
Apr 30		45	423 17	23493 06	65515 58
May 31		55	557 51	76056 85	91019 92
Jun 30		65	1561 10	37399 59	146859 37
July 31		73	1786 76	45683 39	170755 49
Aug 31		84	1661 46	46253 19	215347 22
Sept 30		92	2571 33	50935 67	263711 51
Oct 31		107-A	3646 97	51894 13	311958 67
Nov 30		114	2095 89	59821 33	369684 11
Dec 31		175	7710 35	66589 71	434363 44
"	P. & L.		434363 44		0
1943					
Jan 31			7773 11	70697 28	69469 17
Feb 28		151	1986 84	84636 60	151118 93
Mar 31		163	1679 80	97081 40	246500 53
Apr 30		174	7793 84	73572 65	337799 36
May 30			7345 54	63793 78	399247 60
Jun 30			3943 48	78905 60	474109 72
July 31			1466 64	79146 68	551789 76
Aug 31			3940 40	69484 67	617334 03
Sept 30			1649 72	69400 44	685094 75
Oct 30			3174 08	95071 41	776987 09
Nov 30			4577 96	101242 23	873646 35
Dec 31			2867 20	94083 10	964867 25
"	P. & L.		964867 25		0

EXHIBIT 8-H

SHEET NO.
CREDIT RATING

CREDIT LIMIT

NAME *Karred Surplus*
ADDRESS

BALANCE BROKEN

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
Dec 31	P.R.	16		3181 18	
"	Acc. Inv. Inc. Fed	"	668 05		
"	" " " State	"	177 75		2355 8
<u>1942</u>					
Dec 31	P.R.			39719 93	
"	Acc. Inv. Inc. Trans.			26 98	44137 5
"	Apartment 1940	1264	1477 38		
"	" 1941	"	875 04		
"	" 1942	"	30770 79		9014 8
<u>1943</u>					
Dec 31		2224	177142 18	164877 49	51744 1
<u>1944</u>					
July 19		356		44870 84	
"		"	54046 05		40538 9
Dec 31		419	44870 8	90784 73	176941 5
Feb 28	1000 Inv.	441	65879 17		61017 4
Dec 31	1005 Inv. 1474.61	557		5837 17	66844 5

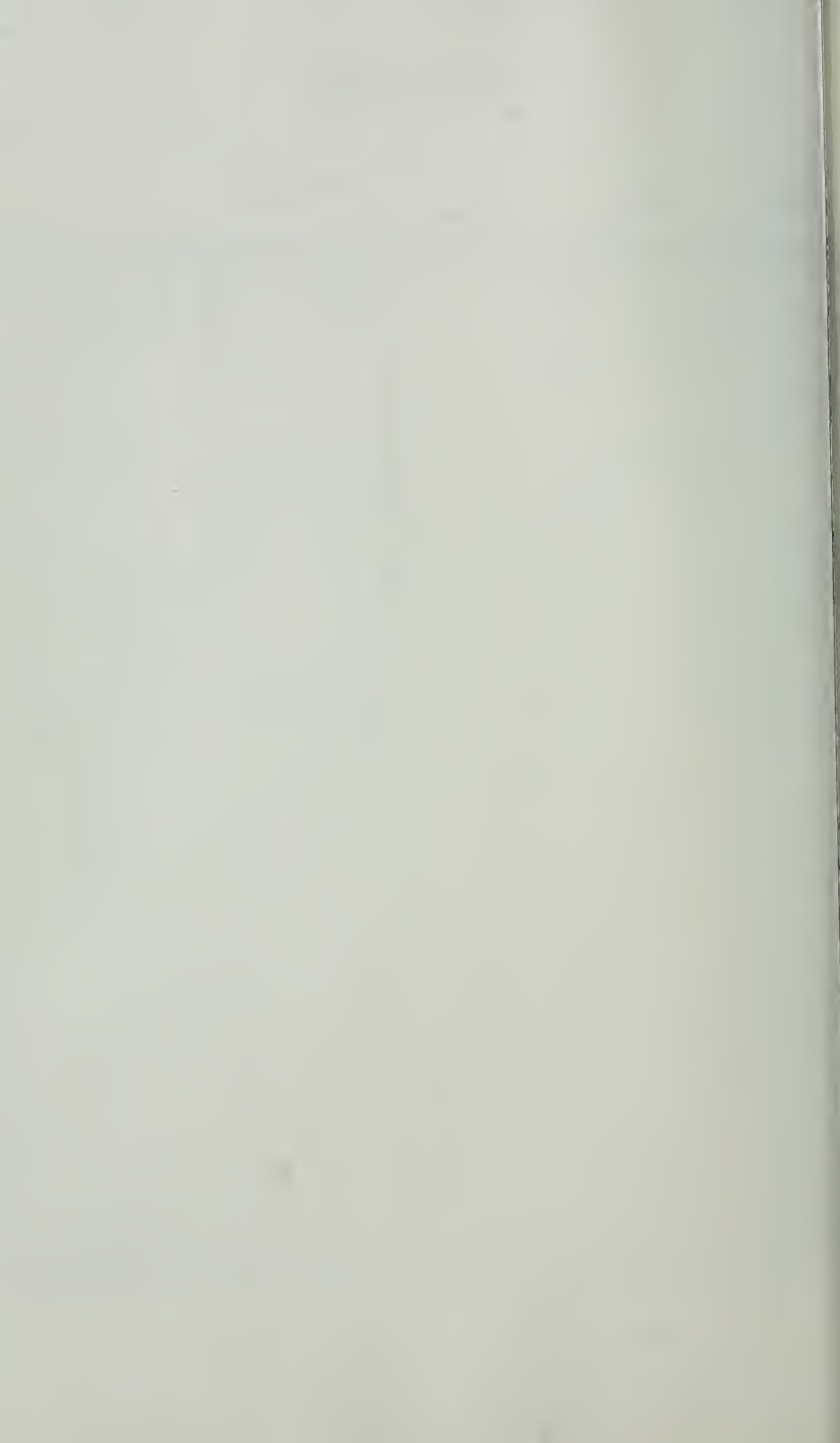


EXHIBIT 9-1

SHEET NO.

CREDIT RATING

CREDIT LIMIT

NAME *M. J. Cunningham Law*
 ADDRESS *Drawing Dept*

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
June 30		91	50.00		50.00
July 31		"	175.00		175.00
Aug 31		94	175.00		300.00
Sept 30		95	200.00		500.00
Oct 31		95	250.00		750.00
Nov 30		97	200.00		950.00
Dec 31		95	400.00		1350.00
"	Salary 3 Mos @ 200 ⁰⁰ 3 Mos @ 350 ⁰⁰	916	330.00	1650.00	2670.00
Jan 31		ER 13	200.00		670.00
Feb 28		978	300.00		2330.00
Mar 31	Salary 3 Mos @ 1000 ⁰⁰ En Dec Dec	936		2940.00	
"	"	936	175.00		2607.00
"	"	"		75.00	2557.00
"	"	"	50.00		
Apr 3		ER 31	250.00		
10		ER 32	150.00		
15		ER 34	150.00		
24		ER 36	150.00		
30		ER 40	150.00		
May 4	Salary	955A		1000.00	2707.00
31	Salary	955	600.00		
June 30	Salary check	"		1000.00	3107.00
"	Salary	965	1500.00		1607.00
"	Ad. 6 Mos. per Minutes 1/14	"		1000.00	2607.00
July 31	check -	973A	994.24		
"	Group Ins	973A	516		7607.00
"	Salary	"		2000.00	9607.00
Aug 31	check -	984	994.80		
"	Group Ins	"	516		8607.00
"	Salary	"		2000.00	10607.00
Sept 30	check -	992A	645		
"	Salary	"	1743.55		
"		"		3000.00	14357.00

SHEET NO.
CREDIT RATING

CREDIT LIMIT

NAME *W. J. Cummings and*
ADDRESS *Drawing Dept*

BALANCE FORWARD

DATE	DESCRIPTION	FOR THE REFERENCE	CHARGES	CHECK	CREDITS	CHECK	BALANCE
	<i>Bal Ford</i>						173570
<i>Oct 31</i>		<i>107A</i>	200000		300000		133570
<i>Nov 30</i>		<i>114</i>	375000		300000		126070
<i>Dec 11</i>	<i>ch</i>	<i>22</i>	75000				
<i>19</i>	"		75000				
<i>24</i>	"		75000				
<i>30</i>	"		75000				
<i>4</i>	"		145000				
<i>"</i>	"		10700				
<i>31</i>	<i>Salary</i>				300000		0

The Tax Court of the United States

[Title of Cause.]

George H. Zeutzius, Esq., and A. P. G. Steffes, Esq., for the petitioner. W. J. McFarland, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND
OPINION

Harlan, Judge: The respondent determined a deficiency in the declared value excess profits tax of petitioner for the year 1942 in the amount of \$1,021.20, and in excess-profits taxes for the same year in the amount of \$28,690.

The questions involved are:

1. Whether respondent correctly disallowed certain amounts as deductions by petitioner on the ground that they constituted exclusive compensation for services rendered by W. J. Cunningham and E. D. Morse during the year 1942, and
2. Whether the respondent correctly disallowed amounts paid by petitioner to each of its directors during the same year.

FINDINGS OF FACT

Petitioner, Walts, Inc., known also by the fictitious name of Aero Alloys, has its principal office and place of business in Los Angeles, California. Its books are kept and its returns filed on the accrual and calendar year basis. Its return for 1942 was filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles.

sum of \$1,140 in obtaining them. A resolution was adopted directing that she be reimbursed for the moneys expended. The directors also authorized the leasing or construction of an adequate plant and the purchase and installation of equipment to maintain said plant for the manufacture of aluminum alloys products. For the purpose of obtaining needed funds, the directors authorized the borrowing of \$8,500 from Dorothy M. Morse, the wife of Elmer D. Morse. The authorized loan was made and petitioner gave its note for \$8,500 to Dorothy M. Morse. Thereafter a building 40x60 feet was leased.

At the March 31, 1941, meeting the board also authorized the payment of salaries of \$200 per month each to Walter J. Cunningham and Elmer D. Morse for their services. It accepted the resignation of Muratta as a director and vice-president and appointed Morse to succeed him as a director. Withers resigned as a director and president of the corporation, and Walter J. Cunningham was appointed president and Morse secretary and treasurer.

At or about the time of the March, 1941, meeting Katharyn S. Cunningham became the owner of 75 shares of petitioner's outstanding stock and Elmer D. Morse the owner of the remaining 75 shares, and this ownership of stock prevailed throughout the remainder of the year 1941 and during the year 1942.

On January 5, 1942, the stockholders of petitioner had a meeting and elected Walter J. Cunningham, Katharyn S. Cunningham, Dorothy M. Morse, and Elmer D. Morse to be directors. At a

directors' meeting on the same day a resolution was adopted that Walter J. Cunningham and Elmer D. Morse each be paid at the rate of \$24,000 per annum for their services effective as of January 1, 1942. Cunningham was elected president, Mrs. Cunningham vice-president, Morse secretary and treasurer, and Mrs. Morse vice-president.

At a meeting held April 10, 1942, petitioner's directors authorized the purchase and installation of a new heat treating furnace at the cost of approximately \$5,000 and the erection of an addition to petitioner's plant, together with necessary equipment, to cost approximately \$3,000.

On June 12, 1942, petitioner's directors authorized its president and treasurer to erect an additional building on the north side of petitioner's plant and to purchase necessary equipment at an expenditure of approximately \$2,500.

At a meeting held August 14, 1942, petitioner's directors adopted a motion "that each director be paid the sum of \$25 for attendance at each meeting of the board of directors".

On August 28, 1942, the Aluminum Company of America wrote petitioner that because of the direct and immediate relationship of the heat treatment of aluminum alloy castings to war time production, the license agreement of February 26, 1941, was to be royalty-free from July 1, 1942, until the cessation of hostilities.

At a meeting held August 28, 1942, petitioner's directors adopted resolutions that Walter J. Cunningham and Elmer D. Morse each be paid at the

rate of \$36,000 per year for their services effective as of September 1, 1942.

During the period August 28, 1942, to December 30, 1942, inclusive, ten recorded directors' meetings were held at which all four directors were present. The discussions in the meetings dealt chiefly with reports on the increase of the business, bank loans, the construction of additions to petitioner's plant, the purchase of necessary additional equipment, the authorization thereof, and of other expenditures; also that arrangements had been completed for a line of credit with the Bank of America up to Twenty-five Thousand Dollars.

During 1942, petitioner's business consisted entirely of the manufacture and sale of airplane parts as a sub-contractor for airplane parts used by aircraft corporations engaged in war work, which said parts were made of aluminum by use of the heating processes covered by the licensing agreements with the Aluminum Company of America.

Petitioner's gross sales in 1940 were \$1,227.38, and it sustained an operating loss for the year ending December 31, 1940, in the amount of \$1,123.58. No salaries were paid by petitioner to any of its officers or directors during 1940. During 1941 petitioner's gross sales amounted to \$39,996.19, and respondent determined that petitioner had an adjusted net taxable income of \$1,205.92. During 1941 it paid salaries to its officers aggregating \$3,300, of which \$1,650 was paid to its president, Walter J. Cunningham, and \$1,650 to its secretary, E. D. Morse, both of whom devoted their entire time to

petitioner's business and operations. During the calendar year 1942 petitioner's gross sales amounted to \$434,363.44, and its net profit before payment of salaries to its officers amounted to \$85,828.39. During 1942 petitioner paid officers' salaries aggregating \$56,000, of which \$28,000 was paid to its president, Walter J. Cunningham, and \$28,000 to its secretary, E. D. Morse, both of whom devoted their full time to the business and operations of petitioner. In addition, each of the four directors were paid \$250 during 1942 for attendance and services at directors' meetings, being at the rate of \$25 per meeting per director for ten of the directors' meetings held during 1942.

No dividends were paid by petitioner at any time during the period April 24, 1941, to December 31, 1942, inclusive.

The gross sales per books of petitioner reflect the following monthly cumulative balances for the period August 31, 1941, to December 31, 1943, inclusive:

Aug. 31, 1941	\$ 7,208.87	Nov. 30, 1942	\$369,684.11
Sept. 30, 1941	10,357.09	Dec. 31, 1942	434,363.44
Nov. 30, 1941	26,789.91		
Dec. 31, 1941	39,996.19	Jan. 31, 1943	\$ 68,469.17
		Feb. 28, 1943	151,118.93
Jan. 31, 1942	\$ 11,982.38	Mar. 31, 1943	246,500.53
Feb. 28, 1942	25,321.67	April 30, 1943	337,799.36
Mar. 31, 1942	42,455.69	May 30, 1943	399,247.60
April 30, 1942	65,515.58	June 30, 1943	474,109.72
May 31, 1942	91,019.92	July 31, 1943	551,789.76
June 30, 1942	126,858.37	Aug. 31, 1943	617,334.03
July 31, 1942	170,755.49	Sept. 30, 1943	685,084.75
Aug. 31, 1942	215,347.22	Oct. 30, 1943	776,982.08
Sept. 30, 1942	263,711.51	Nov. 30, 1943	873,646.35
Oct. 31, 1942	311,958.67	Dec. 31, 1943	964,862.25

In determining the deficiencies, the Commissioner disallowed \$36,000 of the total amount of \$56,000 paid equally to Cunningham and Morse during 1942 and claimed as a compensation deduction by petitioner for the taxable year 1942. The respondent also disallowed directors' fees totalling \$1,000, paid to the four directors for attendance at ten meetings, at the rate of \$25 per meeting.

During the year 1942, both Cunningham and Morse devoted from twelve to fourteen hours each day to their duties as president and secretary and treasurer. Cunningham performed a variety of duties during that year including those of general and production manager, sales promotion, metallurgist, shipping clerk, and inspector of castings. Morse, who operated several sporting goods stores prior to his association with petitioner, handled the financial end of the business, office detail, and matters pertaining to the scheduling of parts out of the foundry. Morse severed his connections with petitioner in June, 1943.

The profit and loss account appearing on the books of the petitioner for the years 1941 and 1942 reflects the following:

	1941	1942
Sales	\$39,996.19	\$434,363.44
Cost of goods sold.....	31,261.93	329,163.97
Gross profit	8,734.26	105,199.47
Compensation of officers.....	3,300.00	56,000.00
Other expenses	3,950.04	19,371.08
Net profit (before taxes).....	1,484.22	29,828.39

A reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner as president and secretary-treasurer, respectively, during the year 1942 was \$10,000 per annum for each.

A reasonable allowance for directors' fees for services rendered by the four directors of petitioner at ten meetings attended by them during the period of August 28, 1942, to December 31, 1942, inclusive, was \$25 per meeting, or a total of \$1,000.

OPINION

The first contention of petitioner is that the respondent is without power to partially disallow as excessive previously authorized salaries actually paid by petitioner during the taxable year 1942, for services rendered to it in the carrying out of its business.

We are not impressed by this contention. Section 23(a)(1)(A) provides that in computing net income there shall be allowed as a deduction "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *." The petitioner argues that the "including" clause was added by Section 234(a)(1) of the Revenue Act of 1918 to make provision for a reasonable allowance as compensation for services rendered, though none was actually paid, in order to rectify the hardship worked upon partnerships, individual proprietorships and closely held corporations by the excess profits provisions of the Act of October 3, 1917, and that the amendment was intended as a liberalization rather than a restriction in its application. Even if it be assumed that petitioner is correct in its argument, respondent's inquiry as to reasonableness could not be logically limited to amounts not actually paid. In *Botany Worsted Mills v. United*

States, 278 U. S. 282, a case which arose under the 1916 Act as amended by the War Revenue Act of 1917, prior to the addition of the so-called "including" clause, the Supreme Court of the United States said:

* * * it is clear that extraordinary, unusual and extravagant amounts paid by a corporation to its officers in the guise and form of compensation for their services, but having no substantial relation to the measure of their services and being utterly disproportioned to their value, are not in reality payment for services, and cannot be regarded as "ordinary and necessary expenses" within the meaning of the section; and that such amounts do not become part of the "ordinary and necessary expenses" merely because the payments are made in accordance with an agreement between the corporation and its officers. Even if binding upon the parties, such an agreement does not change the character of the purported compensation or constitute it, as against the Government, an ordinary and necessary expense. Compare 20 Treas. Dec., Int. Rev., 330; *Jacobs & Davies v. Anderson* (C.C.A.) 228 F. 505, 506; *United States v. Philadelphia Knitting Mills Co.* (C.C.A.) 273 F. 657, 658; and *Becker Bros. v. United States* (C.C.A.) 7 F. (2d) 3, 6.

Subsequent to this decision and the incorporation of the "including" clause in section 23(a)(1)(A), this and other tribunals, in a long line of decisions, have decided that where issue is joined on the question of reasonableness of salaries paid for services rendered, the Commissioner's determination carries a clear presumption of correctness and places upon

the taxpayer the burden of proving that it is entitled to a deduction larger than that determined by the Commissioner. The holding of this tribunal in *Gustafson Manufacturing Company*, (1925), 1 B.T.A. 508, involving the application of Section 234(a) of the Revenue Act of 1918, which brought into the statute the "including" phraseology, that "Under the provision of this section the Commissioner not only has the authority but it is his duty to determine * * * the reasonableness or unreasonableness of deductions by a corporate taxpayer of compensation paid" has been consistently followed. Moreover, the exact wording of what is now Section 23(a)(1)(A), I.R.C. has been incorporated in every revenue act since 1918, and the respondent's regulations have been substantially the same in each reenactment. These regulations have uniformly stated that the test of deductibility of compensation payments is whether they are reasonable and are in fact payment for services. The continued reenactment of the statute must be construed as legislative approval of these regulations. Our conclusion is that the Commissioner has the power under Section 23(a)(1)(A), to disallow as deductions any part of compensation paid which, in his judgment, does not meet the test of reasonableness.

The second contention of petitioner is that the amounts of \$28,000 each paid to Cunningham and Morse during 1942, represent reasonable compensation for services rendered and are allowable deductions for that year. We have found as a fact that \$10,000 per annum for each of these officers constituted reasonable compensation. It follows that our

conclusion is that the remainder of the compensation paid was excessive.

In reaching this conclusion we have carefully considered and weighed the stipulated facts, testimony submitted at the hearing, and the documentary evidence. This reveals to our satisfaction that neither Cunningham nor Morse, at the time each of them became officers of petitioner, were qualified either by training or experience to render unique or specialized services. Cunningham had had a long and varied experience in the lumber business and Morse had operated several sporting goods stores. While it appears that both of them devoted long hours to their respective duties, petitioner's success from August, 1941 to and including 1942, was primarily attributable to the acquisition of the license to use the heating processes owned by the Aluminum Company of America in producing aluminum parts for aircraft corporations and to the demand for such parts during the war years.

The evidence also convinces us that the value of services rendered or to be rendered was not the guiding factor which influenced the directors in authorizing large salaries to be paid to their two officers. On December 31, 1941, the books of petitioner disclose a surplus of \$38.46. Five days later, on January 5, 1942, the directors—Cunningham, Morse and their respective wives—adopted a resolution that the salaries of Cunningham and Morse be increased from \$1,650 per annum received by each in 1941, to \$24,000 per annum. When Cunningham was asked what yardstick was used to determine the amount of salaries voted at this meeting, he replied "past ex-

perience and performances'' and stated that what might occur subsequent to January 5, 1942, was not taken into consideration. When his attention was called to the fact that the gross sales of the company for 1941 were only \$30,996.19, he stated that perhaps they took into consideration previous work that had been done in forming the corporation and that no compensation was received for this work. Cunningham's wife testified that the reason the directors authorized this increase was that her husband had been in the habit of earning that amount of money in the past.

On August 28, 1942, the same day the Aluminum Company of America wrote petitioner that it would have the use of the heat treatment of aluminum alloy castings royalty-free from July 1, 1942, until the cessation of hostilities, petitioner's directors voted Cunningham and Morse a further increase in salary at the rate of \$36,000 per annum effective September 1, 1942. Petitioner's sales which amounted to \$11,982.38 at the end of January, 1942, aggregated \$170,755.49 as of July 31, 1942. Cunningham testified that this increase in sales possibly had some bearing on the increase in salaries. His wife testified that increased production and increased responsibilities warranted the increase to \$36,000 for her husband and Morse. Cunningham on redirect examination testified that on January 5, 1942, the business outlook for petitioner was very promising inasmuch as it had actual orders at that time totalling \$35,000 or \$40,000, and that on August 28, 1942, it had a backlog of unfilled orders of approximately \$500,000.

Petitioner paid Cunningham and Morse \$28,000

each, a total of \$56,000, during 1942, and at the end of the year its books disclosed an earned surplus of only \$9,014.83. Prior to December 31, 1942, it had never distributed any dividends to its stockholders. At all times material herein its stock was owned 50 per cent by Cunningham's wife and 50 per cent by Elmer D. Morse. The salaries paid to Cunningham and Morse were in direct relationship to the stockholdings of the respective families. Although an unimpressive attempt was made to prove that the petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham, evidence as to the value of Morse's services is limited to testimony that as secretary-treasurer he worked long hours, handled the office detail, scheduled the parts out of the foundry, and did the financing. The equality of compensation paid to these two officers seems to us to be inconsistent with an intention to compensate them on the basis of the value of the services they rendered and the evidence presented indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends. Petitioner has not proved to our satisfaction that a salary of \$10,000 per annum for each of them, which was allowed as a deduction by the respondent, did not constitute reasonable compensation for their services.

The remaining issue relates to the fees of \$25 per meeting paid to the four directors of petitioner for attendance at ten meetings, or a total of \$1,000 which was disallowed by the respondent as a deduction for 1942. The evidence discloses that the meetings were

held, that they were attended by all of the directors, and that matters such as business progress, bank loans, construction of additions to plant, purchase of necessary additional equipment and its authorization, and other expenditures, were considered. Our best judgment is the \$1,000 paid to the directors in 1942 constituted reasonable compensation and we have made a finding to this effect. Respondent should have allowed this amount as a deduction.

Decision will be entered under Rule 50.

Entered Jan. 17, 1947.

[Endorsed]: T.C.U.S. Filed Jan. 9, 1947.

[Title of Tax Court and Cause.]

MOTION FOR REHEARING DE NOVO

Petitioner *Walts, Inc.*, a corporation, by *Geo. H. Zeutzius* and *A. P. G. Steffes*, its attorneys, moves the Court to grant an entirely new hearing or rehearing de novo of the above proceeding, and for grounds therefor states:

1. On March 15, 1946, this Court placed this proceeding on the Los Angeles, California, circuit calendar for hearing on the merits.

2. On April 16, 1946, this Court set June 10, 1946 at Los Angeles, California, as the time for said hearing.

3. On June 18, 1946, this proceeding was heard on its merits at Room 229, Post Office and Court House Bldg., Los Angeles, California, before Judge

Eugene Black, who was designated and assigned by the Presiding Judge of this Court, pursuant to Sec. 1103, I.R.C., as a one-judge Division to hear and determine this as well as certain other proceedings at Los Angeles.

4. Under Sec. 1118, I.R.C., it became and was the duty of said Judge Black, as such one-judge Division of this Court, not only to hear but also to determine this proceeding and make a written report thereon and, pursuant to Sec. 1117(b), I.R.C., include in said written report his findings of fact or opinion or memorandum opinion. Section 1118(a), I.R.C., states, in part: "A division shall hear, and make a determination * * *."

5. At the hearing on June 18, 1946, petitioner introduced in evidence the testimony of four witnesses, and exhibits were offered by both sides, together with a partial stipulation of facts. Briefs were filed and, as late as October 30, 1946, said Judge Eugene Black entered an order in this case extending the time for filing petitioner's reply brief.

6. Without any notice of any kind to petitioner of any substitution of Judges, or any order entered or docketed in the case, this proceeding was decided and determined by Judge Byron B. Harlan, whose term of office commenced in March, 1946. Judge Harlan was not present at the hearing in Los Angeles and he did not see or hear any of the four witnesses who testified. Nevertheless, Judge Harlan undertook to determine the issues involved, factual and legal, and filed herein, on January 17, 1947, a written memorandum of his findings of fact and opinion, in

which the disallowance by respondent of \$36,000 of salary deductions was sustained. The first knowledge that petitioner or its counsel had of the substitution of Judge Harlan for Judge Black to determine the case was obtained upon the receipt on or about January 20, 1947 from this Court of a copy of Judge Harlan's memorandum findings of fact and opinion entered January 17, 1947.

7. Said substitution of Judge Harlan for Judge Black, without notice thereof to petitioner or an opportunity to object to such action, has materially prejudiced petitioner and its rights in this proceeding and has deprived it of the full benefits conferred by statute not only of the right to a public hearing (Sec. 1116, I.R.C.) but also of the right to a decision or determination of the issues and to findings of fact by the trial judge (Sec. 1118(b), I.R.C.).

8. Petitioner feels it has been materially prejudiced and aggrieved by the trial judge not disposing of and deciding this proceeding. The evidentiary findings made do not support the ultimate finding in respect of the "reasonableness" or "unreasonableness" of the salary deductions claimed by petitioner. Moreover, if the fact statements in petitioner's brief, which were accepted by respondent, pursuant to Rule 35(b) of this Court, because of his failure to disagree therewith, and those with respect to which there was an insufficient basis shown for disagreement by respondent in his brief, had been considered and adopted, the ultimate finding or conclusion of Judge Harlan as to the salary deductions would be without support. Even on the basis of the findings, as made,

petitioner states that the findings do not support the conclusion drawn therefrom adverse to petitioner.

9. In view of the rule of the Dobson case, Supreme Court, petitioner will be deprived of due process of law and of its right to a fair and full hearing and consideration of the merits of its case, if the present report, findings, conclusions and opinion of Judge Harlan are permitted to stand.

10. In the trial of an income tax case in a United States District Court, petitioner would be entitled to demand that the trial judge himself decide the case, or that a new trial be granted. There is no lawful basis or authority for refusal of similar treatment by the Tax Court in the instant proceeding.

11. The Tax Court erred in permitting the determination of this proceeding to be made by a judge of this Court who did not hear or try the case, and such action on its part constituted an abuse of discretion, particularly in view of the fact Judge Black at all times since the trial of this case by him has been functioning and is still functioning and serving as a judge of this Court.

12. While the Administrative Procedure Act was pending before Congress, the Attorney General of the United States issued a statement to the effect that the term "‘courts’ includes the Tax Court". This Court in *Elizabeth G. MacDonald v. Commissioner*, Docket No. 6910, by Judge Hill, denied a motion to vacate and set aside memorandum findings and opinion on the ground that the Tax Court is a

“court”. (1947 P-H Par. 70, 339.) Being a court, it follows that this case cannot lawfully be decided by any judge other than Judge Black without a new hearing, or the assent of petitioner, which was never given. *Morgan v. United States*, 298 U. S. 468, 480-481.

13. The Judge who made the findings of fact and conclusions, and who filed the opinion and determination herein, erroneously found and determined each and every issue of fact and law which were submitted to the trial judge for determination, and in particular the legal question of the power, or absence of power, of respondent, under Section 23(a)(1)(A), I.R.C., to pass upon the reasonableness of the salaries involved, in view of the facts in this case.

Wherefore, petitioner prays that its motion for an entirely new hearing de novo, be granted, and also such other general and further relief as may be necessary in the premises.

WALTS, INC.,
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Denied Feb. 17, 1947. B. B. Harlan, Judge.

[Endorsed]: T.C.U.S. Filed Feb. 17, 1947.

The Tax Court of the United States
Washington

Docket No. 6974

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to memorandum findings of fact and opinion entered herein January 17, 1947, directing that decision be entered under Rule 50, the respondent, on March 10, 1947, filed a computation for entry of decision which was served on petitioner and came on for hearing on April 9, 1947. Petitioner not having appeared at the hearing or opposed said computation, it is

Ordered and Decided: That there are deficiencies for the taxable year ended December 31, 1942, in declared value excess-profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80.

/s/ BYRON B. HARLAN,
Judge.

Entered Apr. 10, 1947.

[Title of Tax Court and Cause.]

MOTION TO CORRECT DECISION

Petitioner, *Walts, Inc.*, by its attorneys, moves the Court to correct its decision entered herein on April 10, 1947 under Rule 50 in the respects hereinafter set forth, and for reasons therefor states:

1. This Court's decision under Rule 50 provides in part as follows: "there are deficiencies for the taxable year ended December 31, 1942, in declared value excess-profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80."

2. Respondent's proposed recomputation statement, which was filed herein on March 10, 1947, stated in part as follows: "Any deficiency or overpayment relating to excess profits tax set forth herein is subject to adjustment for post-war credits according to the provisions" of the Internal Revenue Code. Respondent further stated in Schedule 5, page 2, of his recomputation statement that there was a deficiency in excess profits tax of \$27,942.80 and that a credit was allowable under Sections 780 and 781 of \$4,944.01 and that there was, therefore, a "Net post-war refund" of \$4,944.01.

3. Petitioner therefor states, without prejudice to its right to contest the correctness of the decision in all other particulars by petition for review in the United States Circuit Court of Appeals, that the decision of this Court, entered April 10, 1947, should be corrected to show that proper adjustment should be made in favor of petitioner with respect to the aforesaid credit and/or post-war refund of \$4,944.01.

4. Petitioner did not file anything in opposition to respondent's proposed recomputation under Rule 50 because petitioner was lead to believe by respondent's statement filed herein that propr adjustment or provision therefor would be made by this Court in its decision with respect to the ten per cent post-war credit. See Section 781(c), I.R.C.

Wherefore, and with the express reservation of the right to challenge the correctness of the decision in all other respects and on any other grounds that may be available to petitioner on appeal, petitioner prays that the decision of April 10, 1947 be corrected in accordance with the foregoing information, which is in agreement with respondent's proposed recomputation.

WALTS, INC.,
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Denied. April 21, 1947.
Signed B. B. Harlan, Judge.

[Endorsed]: T.C.U.S. Filed April 18, 1947.

[Title of Tax Court and Cause.]

PETITION FOR REVIEW BY THE UNITED
STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

I.

JURISDICTION

Petitioner, Walts, Inc., respectfully petitions this Honorable Court to review the decision of the Tax Court of the United States, entered on April 10, 1947, finding a deficiency in the declared value excess profits tax and in the excess profits tax due from your petitioner for the calendar year 1942, in the respective amounts of \$955.20 and \$27,942.80.

Petitioner is a corporation organized under the laws of the State of California, having its principal office and place of business at Los Angeles, California.

The returns of income and declared value excess profits tax and excess profits tax, in respect of which the aforementioned tax liabilities arose, were filed by your petitioner with the Collector of Internal Revenue for the Sixth Collection District of California, at Los Angeles, California, which office is within the jurisdiction of the Circuit Court of Appeals for the Ninth Judicial Circuit.

Jurisdiction in this Court to review the aforesaid decision of the Tax Court of the United States is founded on Sections 1141 and 1142 of the Internal Revenue Code (Sections 1001-3, Revenue Act of

1926, as amended by Sections 603, Revenue Act of 1928, 1101, Revenue Act of 1932, and 519, Revenue Act of 1934).

II.

NATURE OF CONTROVERSY

Petitioner was incorporated in April, 1940 and, during the taxable year 1942, was engaged in the manufacture and sale of aluminum aircraft parts, made in its foundry by sand casting and special heat treating processes.

On October 27, 1944, respondent sent to petitioner a notice of deficiency, as prescribed by Section 272 (a), I.R.C. The notice showed a deficiency of \$1,021.20 in declared value excess profits tax for the taxable year ending December 31, 1942, and a deficiency of \$28,690.00 in excess profits tax for said year.

These claimed deficiencies grew out of several adjustments made by respondent to petitioner's 1942 tax returns, among them the disallowance of \$36,000 of the total compensation of \$56,000 paid to its two principal officers for services actually rendered during the year, and the disallowance of \$1,000 paid as directors' fees. The officers' salaries in question were fixed by previous corporate action. The only reason assigned by respondent, for the disallowance of \$36,000 of the officers' compensation, was shown in his deficiency notice as follows:

“(b) It is determined, under the provisions of section 23(a)(1) of the Internal Revenue Code, that the deductions claimed for compensation of certain

of your officers are in excess of a reasonable compensation for services rendered by said officers as shown in the following:

"Name and Title	Amount Claimed	Reasonable Compensation	Excessive Amount
W. J. Cunningham, Pres.	\$28,000.00	\$10,000.00	\$18,000.00
E. D. Morse, Secty.	28,000.00	10,000.00	18,000.00
Totals	\$56,000.00	\$20,000.00	\$36,000.00

“The excessive amount of \$36,000.00 is disallowed as a deduction.”

(Note: Respondent made no allegation, determination or suggestion in his deficiency notice that the disallowed amounts constituted a distribution of earnings or dividends in the guise of salaries or compensation.)

On January 23, 1945, petitioner filed a petition with the Tax Court of the United States seeking a redetermination of its 1942 tax liabilities, alleging that respondent erred in making each of the aforesaid adjustments.

On March 12, 1945, respondent filed his answer to the petition, merely denying all errors assigned and the facts alleged in support thereof, and praying that the Tax Court approve his determination of petitioner’s tax liabilities for 1942. No facts or statements were alleged by respondent in support of or in connection with his denials.

On June 18, 1946, petitioner filed an amendment to its petition, adding to the errors previously assigned the further allegation that respondent exceeded his jurisdiction, powers and authority in assuming visitatorial power over the salary payments through the medium of a disallowance of part of the

payments actually made by petitioner during 1942 for services actually rendered in the conduct of petitioner's business operations. Respondent filed his answer to this amendment to petitioner's petition on June 18, 1946, merely denying all allegations, without setting forth any additional facts or statements of any matters upon which respondent intended to rely for defense.

Thereafter, on June 18, 1946, the cause came on for hearing at Los Angeles before Division 15 of the Tax Court, to which Judge Eugene Black was assigned by the Presiding Judge of the Tax Court, in accordance with law, as a one-member Division of the Tax Court of the United States. As such one-member Division, it became and was the statutory duty of said Judge Black to hear and determine petitioner's case. Judge Black, on June 18, 1946, did hear the case, as trial judge, at Los Angeles.

On January 17, 1947, without prior notice to petitioner or its counsel that the trial judge was not going to decide the case, a "Memorandum of Findings of Fact and Opinion" was rendered and filed in the cause by Judge Byron B. Harlan, whose term as a Judge of the Tax Court commenced June 2, 1946. There was no entry of any order of transfer of the case from Judge Black to Judge Harlan, who was the incumbent of Division 11 of said court. The docket in the case also fails to show any official action transferring the case for decision. Neither petitioner nor its counsel had any knowledge or notice whatsoever that its case had been transferred to another judge for decision.

In said memorandum of findings of fact and opin-

ion, the rulings were in favor of respondent and against petitioner on all issues involved, with the exception of the issue on the disallowance of \$1,000 of directors' fees, which fees were allowed.

On April 10, 1947, the Tax Court of the United States, by Judge Byron B. Harlan, entered its decision in the above-entitled cause as follows:

“Ordered and decided: That there are deficiencies for the taxable year ended December 31, 1942, in declared value excess profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80.”

On February 17, 1947, petitioner filed a motion for rehearing *de novo* and for such other general relief as may be necessary in the premises, which motion was accepted for filing and was referred to Judge Byron B. Harlan of the Tax Court of the United States, who, upon consideration thereof, denied the same under date of February 17, 1947. One of the grounds of this motion was that petitioner had the right by statute to have the trial judge both hear and determine the case. Other grounds concerned the sufficiency of the findings as support for the adverse conclusions made, erroneous findings on the issues because of the Tax Court's failure to apply its own rules respecting briefs and other errors which operated to deprive petitioner of its right to a public hearing and a determination by the trial judge of the issues tried.

On April 18, 1947, petitioner filed a motion to correct the decision entered April 10, 1947, set forth above, which motion was denied on April 21, 1947 by Judge Byron B. Harlan, acting for the Tax

Court of the United States. The ground of this motion was that the Tax Court failed, in entering its decision under Rule 50, to allow or make proper adjustment in its deficiency computation for the ten per cent (10%) postwar credit of \$4,944.01 provided for under Sections 780 and 781, I.R.C., and set forth in respondent's computation for entry of decision, filed in the proceeding.

ASSIGNMENT OF ERRORS

The Tax Court of the United States committed the following errors, which petitioner assigns and relies upon as the basis of this proceeding:

1. The Court erred in not allowing petitioner, in its decision entered pursuant to Rule 50, the ten per cent (10%) post-war credit of \$4,944.01, admittedly allowable under Sections 780 and 781, I.R.C., and in denying petitioner's motion to correct its decision, in respect thereof.

2. The Court erred in permitting and causing the determination of the issues presented by the pleadings herein to be made by an unauthorized one-member Division of the Court, which did not try the case, hear the evidence or observe the witnesses.

3. The Court erred in denying petitioner's motion for rehearing de novo.

4. The Court was without authority to transfer petitioner's proceeding from Division 15, which heard the case, to Division 11 for the determination thereof, without petitioner's knowledge or consent, the incumbent of Division 15 having been at all material times functioning and serving as a Judge of said Tax Court.

5. The Court erred in holding that the Commissioner of Internal Revenue has the power, under Section 23(a)(1)(A), I.R.C., to disallow in part, solely on the grounds of excessiveness or unreasonableness, salaries actually paid during the taxable year 1942, to petitioner's two managing officers, pursuant to previous corporate authorization therefor, for services actually performed by them.

6. If, under Section 23(a)(1)(A), I.R.C., respondent had authority to exercise visitatorial power over salary payments, through the medium of disallowing part of the payments actually made, the Court erred in finding that "a reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner * * * during the year 1942 was \$10,000 per annum for each".

7. The Court erred in holding that \$18,000 of the full amount of \$28,000 each, paid by petitioner to Cunningham and Morse during 1942, for their services, was excessive and unreasonable.

8. The Court erred in rejecting (in its memorandum opinion) as unimpressive, the uncontradicted testimony of Cunningham which established that petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham in 1942.

9. The Court erred in holding and concluding that the evidence presented "indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends", inasmuch as no such issue was presented by the pleadings, either in their original form or as

amended, and respondent had not assigned any such contention in his deficiency determination.

10. The Court erred in failing to find all of the facts as stipulated by the parties.

11. The Court erred in failing to follow and apply its own Rules, Nos. 35 and 35(b), in arriving at its findings of facts herein, e.g., under petitioner's statement of facts, Paragraph No. 19, which was accepted by respondent in his brief by operation of the provisions of Rule 35, it clearly appeared, without any contradiction in the evidence, that as to Cunningham more than \$42,000 would have had to be paid to others by petitioner if it had been required to hire others to perform the services which he rendered for it in 1942.

12. The Court erred in failing to find and hold that the amounts of \$28,000 paid to each, Cunningham and Morse, as compensation for services rendered in 1942, represented reasonable compensation and was, therefore, properly deducted by petitioner.

13. The Court erred in that while it held that the equality of compensation paid to Messrs. Cunningham and Morse was inconsistent with an intention to compensate them on the basis of the value of their respective services, it nevertheless found and concluded that the value of the services of each for 1942 was equal in amount, namely, \$10,000.

Wherefore, your petitioner prays that this Honorable Court may review the decision and order of, and all of the proceedings heretofore had, before the Tax Court of the United States to the end that the

errors and omissions of the Tax Court of the United States may be corrected; that the Tax Court's decision of the findings and conclusions be reviewed and set aside; that the Tax Court be directed to enter an order, in the above entitled cause, of "No Deficiency" under the evidence, or to grant an entirely new hearing; and for the entry of such further orders and directions as shall by this Court be deemed meet and proper, in accordance with law.

WALTS, INC.,
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

By /s/ A. P. G. STEFFES,
Attorneys for Petitioner.

State of California,
County of Los Angeles—ss.

Geo. Zeutzius, being duly sworn, says:

I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. The petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 2nd day of July, 1947.

(Seal) /s/ A. P. G. STEFFES,

Notary Public in and for said County and State.

[Endorsed]: T.C.U.S. Filed July 7, 1947.

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW
AND ACCEPTANCE OF SERVICE
THEREOF

To Commissioner of Internal Revenue, Internal Revenue Building, Washington, D. C., and Chief Counsel for Bureau of Internal Revenue, Attorney for Respondent, Internal Revenue Building, Washington, D. C.:

You Are Hereby Notified that on the 7th day of July, 1947, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States, heretofore rendered in the above-entitled cause, was filed with the Clerk of said Court.

A copy of the petition, as filed, is attached hereto and served upon you.

Dated July 7th, 1947.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

(Acknowledgment of Service.)

[Endorsed]: T.C.U.S. Filed July 8, 1947.

In the United States Circuit Court of Appeals
For the Ninth Circuit

Docket No. 6974

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION FOR EXTENSION OF TIME
TO FILE CERTIFIED RECORD ON RE-
VIEW AND ORDER THEREON

It Is Hereby Stipulated that petitioner's time within which to file the certified record on review with the Clerk of the above entitled Court may be extended to and including December 15, 1947, for the following reasons:

Certain negotiations having for their objective the settlement, compromise and payment of all claimed income tax liabilities of petitioner to the Government of the United States, including its income tax liability for the year 1942, which is the subject matter of the petition for review filed by petitioner in these proceedings, certain negotiations are now being carried on between the Technical Staff of the Commissioner of Internal Revenue at Los Angeles and counsel for petitioner, and there is a reasonable probability that as the result of the cooperation between petitioner and respondent a settlement and compromise can be effected. In the event such settlement and compromise is effected, it will be unnecessary to

proceed with the petition for review herein and considerable expense will be saved to petitioner if petitioner is not compelled to file with the Clerk of the above entitled Court the record on review until December 15, 1947.

Dated August 1, 1947.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

/s/ CHARLES OLIPHANT,

Acting Chief Counsel, Bureau of Internal Revenue.

It Is So Ordered this 12th day of August, 1947.

/s/ ALBERT LEE STEPHENS,

Circuit Court Judge.

A True Copy. Attest: Aug. 13, 1947. Paul P. O'Brien, Clerk. By Frank H. Schmidt, Deputy Clerk.

[Endorsed]: Filed Aug. 13, 1947. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

AFFIDAVIT IN SUPPORT OF REQUEST FOR
EXTENSION OF TIME TO FILE RECORD
ON REVIEW

County of Los Angeles,
State of California—ss.

Geo. H. Zeutzius, being first duly sworn, deposes and says:

That he is one of the attorneys of record in the

above case and that he has read the attached Stipulation for Extension of Time to File Certified Record on Review, which stipulation has been signed by the Acting Chief Counsel for the Bureau of Internal Revenue at Washington, D. C.; that the statements contained in said stipulation for extension of time are true and are presented to the above entitled Court as a basis for the request contained in said stipulation for an extension of the time until December 15, 1947, within which petitioner may file its certified record on review with the Clerk of the above entitled Court.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 11th day of August, 1947.

/s/ GLORIA WEAVER,

Notary Public in and for the County of Los Angeles,
State of California.

My commission expires May 27, 1950.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE
RECORD ON REVIEW

Upon the application of counsel for petitioner,
and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within
which to file the certified record on review with the

Clerk of this Court be, and the same hereby is, extended to February 1, 1948.

Dated December 12, 1947.

/s/ ALBERT LEE STEPHENS,
Circuit Court Judge.

A True Copy. Attest: December 13, 1947, Paul P. O'Brien, Clerk.

[Endorsed]: Filed December 13, 1947. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Dec. 22, 1947.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE RECORD
ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to April 15, 1948.

Dated January 29, 1948.

FRANCIS A. GARRECHT,
Circuit Court Judge.

A True Copy. Attest: Jan. 29, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Jan. 29, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed Feb. 3, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to July 15, 1948.

Dated April 12, 1948.

FRANCIS A. GARRECHT,
Circuit Court Judge.

A True Copy. Attest: April 13, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Apr. 13, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed April 19, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within

which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to October 15, 1948.

Dated July 8, 1948.

/s/ FRANCIS A. GARRECHT,
Circuit Court Judge.

A True Copy. Attest: July 8, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed July 8, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed July 12, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to December 15, 1948.

Dated October 13, 1948.

WILLIAM DENMAN,
Chief Judge, U. S. Court of Appeals for the Ninth
Circuit.

A True Copy. Attest: October 13, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Oct. 13, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed Oct. 18, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to January 1, 1949.

Dated December 14, 1948.

WILLIAM DENMAN,

Chief Judge, U. S. Court of Appeals for the Ninth Circuit.

A True Copy. Attest: Dec. 14, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Dec. 14, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed Dec. 20, 1948.

The Tax Court of the United States

Docket No. 6974

[Title of Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON REVIEW

To the Clerk of the Tax Court of the United States:

Petitioner, Walts, Inc., being also the petitioner on review, hereby designates for inclusion in the record for consideration by the United States Court of

Appeals for the Ninth Circuit on review of the decision of the Tax Court of the United States, the entire original files and proceedings in the above-entitled case, including the following:

1. Docket entries.
2. Petition (with annexed deficiency notice) and amendment to petition.
3. Answer and answer to amendment to petition.
4. The reporter's transcript of all proceedings before the Tax Court, together with all exhibits introduced in evidence at the hearing before the Tax Court. (Note: A thirteen-page Stipulation of Facts was filed with the Tax Court during the trial and so marked. It had attached thereto as part thereof joint Exhibits 1-A to 9-I, inclusive. During the Tax Court hearing, the only additional exhibits introduced were marked as Petitioner's Exhibits 10 and 11 and Respondent's Exhibits J, K, L, M and N.)
5. The above-mentioned Stipulation of Facts with its attached Exhibits 1-A to 9-I, inclusive.
6. Memorandum findings of fact and opinion.
7. Motion for rehearing de novo and order of February 17, 1947 of Judge Harlan denying motion.
8. Decision of the Tax Court entered April 10, 1947.
9. Motion to correct said decision, filed April 18, 1947, and order of April 21, 1947 denying motion.
10. Respondent's computation for entry of deci-

sion, together with its accompanying computation, filed March 10, 1947.

11. Petition for review by the United States Court of Appeals for the Ninth Circuit.

12. Notice of filing petition for review and acceptance of service thereof.

13. Stipulation dated August 1, 1947 for extension of time to December 15, 1947, in which to file certified record on review and order thereon of August 12, 1947, granting said extension.

14. Order entered December 12, 1947 extending time to February 1, 1948 to file record on review.

15. Order entered January 29, 1948 extending time to April 15, 1948 to file record on review.

16. Order entered April 12, 1948, extending time to July 15, 1948 to file record on review.

17. Order entered July 8, 1948, extending time to October 15, 1948 to file record on review.

18. Order entered October 13, 1948, extending time to December 15, 1948 to file record on review.

19. Order entered December 14, 1948, extending time to January 1, 1949 to file record on review.

20. This designation of contents of record on review, together with acknowledgment of service by respondent and any stipulation appended thereto.

Request is hereby made that said record be certified and transmitted by the Clerk of the Tax Court of the United States to the Clerk of the United

States Court of Appeals for the Ninth Circuit, as required by law and the rules of said Court of Appeals, and particularly its Rule 11, as amended, effective January 1, 1949.

Dated December 22, 1948.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Counsel for Petitioner.

Personal service of a copy of the foregoing Designation is hereby acknowledged as having been made this 27th day of December, 1948.

/s/ CHARLES OLIPHANT,

Chief Counsel for the Bureau of Internal Revenue.

It Is Hereby Stipulated that the foregoing designation contains a designation of the entire record and proceedings in the case and respondent hereby waives the right under Rule 75(a) of the Federal Rules of Civil Procedure to designate additional portions of the record on review in the above-entitled case.

Dated December 27, 1948.

/s/ CHARLES OLIPHANT,

Chief Counsel for the Bureau of Internal Revenue,
Counsel for Respondent.

[Endorsed]: T.C.U.S. Filed Dec. 27, 1948.

The Tax Court of the United States
Washington

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 29, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Stipulated Designations of Contents of Record on Review" in the proceeding before The Tax Court of the United States entitled "Walts, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent", Docket No. 6974 and in which the petitioner in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 31st day of December, 1948.

(Seal) /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

Before The Tax Court of the United States

Docket No. 6974

In the matter of: *Walts, Inc.*, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Room 229, United States Post Office and
Court House Building,

Los Angeles, California

June 18, 1946—9:30 a.m.

(Met pursuant to notice.)

Before: Honorable Eugene Black, Judge.

Appearances: Zeutzius & Steffes, By George H. Zeutzius, Esq., 510 South Spring Street, Los Angeles, California, appearing on behalf of *Walts, Inc.*, Petitioner. W. J. McFarland, Esq., (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent. [1*]

PROCEEDINGS

The Clerk: 6974, *Walts, Incorporated*.

The Court: Are you ready in the *Walts, Incorporated*, case?

Mr. Zeutzius: Ready.

Mr. McFarland: Ready for the respondent.

The Court: Will you state the appearances for the petitioner?

Mr. Zeutzius: For the petitioner, George H. Zeutzius, and my partner, who is not present in court this morning, P. G. Steffes. We appear of record

* Page numbering appearing at foot of page of original certified Reporter's Transcript.

as counsel. I happen to be here alone this morning, without him. He is out of the city for the day.

Mr. McFarland: W. J. McFarland for the respondent.

The Court: Very well. Petitioner's counsel may make an opening statement of the issues in the case.

* * * *

Mr. Zeutzius: Now the stipulation of fact signed by the parties, I take it, will have to be offered in evidence.

The Court: Yes, that is right.

Mr. Zeutzius: So the stipulation as offered, having in mind that normally I would first confine the evidence to the first point and have it determined, but in view of what has transpired here I shall just offer the entire stipulation.

The Court: Yes. It does not have the effect of waiving your contention on the first point. The stipulation of facts will be received in evidence.

Mr. Zeutzius: It is a joint exhibit.

The Court: Yes, the stipulation of facts, together with the exhibits attached thereto, is received in evidence.

Mr. Zeutzius: In order to round out with reference to the stipulation certain other of the statements in the stipulation, I would like to ask Mr. McFarland at this time if he has the originals of the 1940, 1941 and 1942 income tax returns of the petitioner.

Mr. McFarland: I do not have the originals of the 1940, if the court please. I have the original 1941 corporation income declared value excess profits tax return, and I have the corporation 1942 income

declared value and [15] excess profits tax return, which I will offer in evidence at the proper time.

Mr. Zeutzius: Would it be permissible for counsel to offer them out of turn? I might like to use them.

Mr. McFarland: Whichever the court wishes.

The Court: Well, the respondent can now offer them as his Exhibits A and B. Suppose you offer the corporation's declared value income tax return and declared value excess profits return for 1941 as Respondent's Exhibit A.

Mr. McFarland: Well, if the court please, we have exhibits in the stipulation that run from A to I. Can this be Respondent's Exhibit J?

The Court: Yes, I think we better make it Respondent's Exhibit J.

It will be received as Respondent's Exhibit J.

(The return referred to was marked and received in evidence as Respondent's Exhibit J.)

Mr. McFarland: That is the 1941 corporation income declared value excess profits tax return of Walts, Incorporated. As Respondent's Exhibit K, the 1942 corporation income declared value excess profits tax tentative return and final corporation income and declared value excess profits tax return, together with the corporation excess profits tax return for the same year. [16]

The Court: It will be received in evidence as Respondent's Exhibit K.

(The return referred to was marked and received in evidence as Respondent's Exhibit K.)

Mr. McFarland: If the court please, before we start in on the evidence, I should like to have a rule excluding the witnesses from the court room.

The Court: Are there any witnesses in the court room? Of course, the petitioner himself has a right to be present.

Mr. McFarland: That would be an officer.

The Court: Yes, I mean the officers.

Mr. Zeutzius: We have two officers and no other witnesses here now.

The Court: The president, and who is the other officer?

Mr. Zeutzius: A director, who is a director during this period.

The Court: Well, I should think if the respondent insists on his exclusion, that only the president should be permitted to remain and the director would not be.

Mr. Zeutzius: Well, the evidence of the director will be very brief.

The Court: Yes, I know, but I think if the respondent insists on the rule that the only officer that would [17] be regarded as necessary in the case to remain in the court room would be the president.

Mr. Zeutzius: May I say this, the director, I believe, is also a vice-president, and she is directly interested because fees were paid to that director as a director for services, just like——

The Court: That is not in the case. I will rule if the respondent insists that the director be excluded, that the director would have to be excluded and the president remain to advise counsel.

Mr. Zeutzius: Well, may the petitioner note an exception to your Honor's ruling?

The Court: Yes. Is the director in the room at present?

Mr. Zeutzius: Yes.

The Court: She may retire, and Mr. Tonjes, can you direct her to some suitable place to remain?

Mr. Zeutzius: Let the record show—

Mr. Tonjes: I don't know any except your Honor's chambers.

The Court: That will be all right. She may have a seat in there.

Mr. Zeutzius: The director in question and vice-president is Mrs. Cunningham.

The Court: Yes. [18]

Mr. Zeutzius: Will counsel furnish the petitioner with photostatic copies of the 1941 and 1942 returns just offered?

Mr. McFarland: I make the motion, if the court please, that I be allowed to substitute photostats and withdraw the originals of the exhibits.

The Court: Yes, you may have that permission.

Mr. Zeutzius: In connection with what I understood, counsel had agreed upon in the event of the 1940 return of the petitioner, income tax return not reaching the court before the trial, that petitioner might offer petitioner's retained copy of the 1940 income declared value and excess profits tax return with the understanding that the court would be asked for permission to permit its withdrawal and substitution of photostats—

Mr. McFarland: And also I should like, I have requisitioned the original from Washington, and I

believe we agreed that if the original does not conform to the copy in any respect we will substitute the original. Is that understood?

The Court: Yes, that agreement may be understood. And the document you wish now to offer in evidence, do you, Mr. Zeutzius?

Mr. Zeutzius: Yes, your Honor.

The Court: It will be received in evidence as [19] Petitioner's Exhibit 10, and permission is granted to substitute photostatic copy.

(The return referred to was marked and received in evidence as Petitioner's Exhibit No. 10.)

Mr. Zeutzius: I would like to ask counsel at this time if he has obtained a collector's transcript concerning the taxes paid for 1940, 1941 and 1942, in accordance with our oral understanding.

Mr. McFarland: No, I have not. I have ordered it and it is in the process of being either made up or being sent. When it is available, I will gladly show it to counsel.

The Court: You want to offer it in evidence?

Mr. McFarland: I believe not. I do not believe it is a part of the record, if the court please. It is merely a statement from the Collector's office showing the various payments on the various taxes as reported by the petitioner corporation, and as I understand it, the payments on the amount that was paid is not an issue here.

The Court: What would be the object of introducing it?

Mr. Zeutzius: In connection with the whole picture, your Honor. We asked it to appear not only

what was the gross income or the gross sales and net income, but what taxes were paid. I think it is very important as bearing [20] upon the entire picture. Here is the thing, what taxes did the petitioner pay?

Mr. McFarland: No, I don't think that it is at all pertinent to the issue which is to be heard right now, if the Court please.

Mr. Zeutzius: In most of the cases on the salary question it is indicated in the opinion what taxes were paid for several years, the year in question and other years.

The Court: I can't see how that would be material at all to the question whether the salaries are reasonable. I remember many decided cases, but I don't recall any of them where that question was deemed to be involved.

Mr. Zeutzius: Well, I would like to ask counsel for the government to produce the refund claim filed for 1941 and 1942, the originals thereof, by petitioner.

Mr. McFarland: If the Court please, there was no notice on me to produce, and I don't believe I had them.

Mr. Zeutzius: You had them in your office a week ago, you recall, and on the back of the claim is the certificate by the Collector.

Mr. McFarland: I don't have them here.

Mr. Zeutzius: As to the payments made.

Mr. McFarland: I don't have them here, if the Court please, and furthermore I don't see the materiality of it or that it goes to prove a single evidentiary or [21] ultimate fact.

The Court: In this case there is no claim of an overpayment, is there?

Mr. McFarland: No claim.

Mr. Zeutzius: Your Honor, there is \$130.00 determined as the result of a juggling of all the figures, due to action taken by the Commissioner, and it may well be that if the Commissioner were to be sustained there would be a \$130.00 overpayment for which we should be allowed credit.

The Court: Well, that is not an issue before us, however, as he has allowed it in the deficiency notice and we have no jurisdiction over assessments at all. The only thing that is involved in this case is whether or not the taxpayer is to be held liable for a declared value excess profits tax deficiency, the excess profits tax deficiencies which are named in the deficiency notice. Now, those deficiencies, as I understand it, are due altogether to the Commissioner's disallowance of parts of the salaries paid to the two officers of the petitioner, to-wit, Mr. Cunningham and Mr. Morse. That is the issue that we have. If the Court should sustain the petitioner in its claim that the salaries were reasonable, then as I understand it, there will be no deficiency. On the other hand, if we should not sustain the petitioner or we sustain it in part, then there would be a deficiency. Now, I can't see the relevancy of [22] any claim for a refund.

Mr. Zeutzius: Your Honor, I was anxious, of course, to include the thousand-dollar item for fees to directors.

The Court: Yes, I understand that.

Mr. McFarland: They are not an issue, if the Court please.

Mr. Zeutzius: We think, however, that as a part of the showing of the progress and success of the corporation and that officers, the particular ones were responsible for that growth, that we are entitled to show, especially where the incorporation is so close in proximity of time to the taxable year, namely, something like a year and a half, we are entitled to show what was the result of its operations in 1940, '41 and '42 for comparison.

The Court: Well, I think you may show that.

Mr. Zeutzius: In that connection we would like the Court to know anything we are entitled to show what taxes they paid.

The Court: No, I don't think that would be material, but it is all right for you to show the progress of the company, for example, the business done in 1940, the business done in 1941 and the business done in 1942. The Court will certainly be disposed to allow you to make a full showing, but would rule that it is not material to show what taxes were paid in those years, because we do not have those [23] years before us.

Mr. Zeutzius: May I on behalf of the petitioner make this offer of proof, that if the proof were permitted to go in as shown by the records of the Collector of Internal Revenue at Los Angeles, that for 1940 petitioner would be shown to have paid—no, there would be no income tax paid for 1940, no declared value excess profits tax, and no excess profits tax paid by the Commissioner for 1940.

Mr. McFarland: Paid by the Commissioner?

Mr. Zeutzius: I mean by the petitioner, I am

sorry. Nothing was paid in 1940, our proof would show. We so offer to make that proffer.

We would proffer to show that the rejected evidence would disclose that petitioner paid \$641.32 in income tax to the Collector, being the amount of liability reported on its 1941 return which is in evidence. For 1942 we proffer to show by the rejected evidence that the petitioner paid total taxes to the Collector of \$23,001.75, consisting of an income tax of \$1,504.48 as shown in the last return which is in evidence, and \$21,497.27 excess profits tax, as shown by its return also in evidence.

The Court: Very well. The record will show your proffered evidence and respondent files his objection to it as immaterial, which objection is sustained, and the offer of the petitioner is denied. [24]

Mr. Zeutzius: Now, with respect to Paragraphs 1 and 2 of the petition, that has been admitted by the answer, and I would like to see counsel's revised answer which was just filed this morning. Is my understanding correct, your Honor, that where the pleadings contain admissions it is not necessary in the Tax Court's practice to read in evidence the admissions?

The Court: That is right. If the answer, as it usually does, admits certain things, those are no longer an issue and no evidence need be offered.

Mr. McFarland: Counsel has reference to the 90-day letter.

Mr. Zeutzius: The first two paragraphs have not been amended, are just as petitioner filed them. We are going to offer them with the exhibits as attached, copies of the documents attached there to the petition. It is a true copy.

Mr. McFarland: We have admitted them.

The Court: Yes, that is all admitted.

Mr. Zeutzius: One more point I had. We produce to counsel checks aggregating a thousand dollars, representing the directors' fees paid during the period subsequent to the August 14, 1942, meeting at which the payment of directors' fees was authorized by a corporate resolution of the petitioner, as shown by the stipulation of facts in [25] evidence. Does counsel wish to examine the checks?

Mr. McFarland: I would like very much to, yes.

Mr. Zeutzius: While counsel is examining the checks, does the Court wish me to proceed?

The Court: Yes, you may proceed, because if you wish to introduce the checks, that can be done.

Mr. Zeutzius: Will you take the stand, Mr. Cunningham?

Evidence on Behalf of Petitioner

Thereupon, the petitioner, to maintain the averments of its petition, introduced the following proof:

Whereupon:

WALTER JAMES CUNNINGHAM,
called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Walter James Cunningham?

A. That is correct.

Q. What is your age? A. 48.

Q. Where were you born?

A. Buffalo, New York.

(Testimony of W. J. Cunningham.)

Q. For how long did you live in Buffalo? [26]

A. Approximately eight years.

Q. Where did you then go?

A. Moved from there to Rochester, New York.

Q. And with whom? A. With my family.

Q. And you mean by that—

A. My mother and father and sisters.

Q. Where did you receive your education?

A. Public school, high school, graduated from high school, and two years of business college.

Q. What high school?

A. West High School, Rochester, New York.

Q. And your business education was also received in Rochester?

A. Also received at the Rochester Business Institute, and after that took a year at Williams, which is an advanced school for business training.

Q. Were you offered any further educational privilege?

A. Yes, I was offered a scholarship at Colgate University.

Q. Did you accept? A. No, I did not.

Q. Why not?

A. Well, by reason of the fact that the war had started and I enlisted a week after war was declared.

Q. Do you mean the war which started in 1917?

A. That is correct, yes.

Q. How long did you serve in the war?

A. 18 months, a year in this country and eight months overseas.

Q. And in what branch of the service did you function overseas?

(Testimony of W. J. Cunningham.)

A. Machine gunner, 106th Machine Gun Battalion, and after that we were the 102nd Supply Train.

Q. Did there come a time when you were discharged? A. Yes, sir.

Q. Honorably?

A. Honorably discharged, yes. I have a discharge paper here.

Q. When?

A. I believe that was in '19, about February, 1919.

Q. What did you do after you were discharged?

A. Well, I took a job first thing with the Travelers Insurance Company as a claim adjuster.

Q. How long did you hold that job?

A. Oh, approximately a year.

Q. And then?

A. And then following that my father, who had been engaged in the lumber business for a period of many years, wholesale lumber business, I entered into an arrangement [28] with him. Incidentally, I was the fourth generation in the lumber business at that time.

Q. Of your family?

A. Of my family back.

Q. When did you enter this lumber business?

A. Well, I entered about 1920.

Q. How long did you remain there?

A. From 1920 until 1935, 15 years.

Q. What was your position with the—what was the name of the lumber company?

A. J. P. Cunningham Lumber Company, Inc.

Mr. McFarland: Where was that located?

(Testimony of W. J. Cunningham.)

The Witness: It was located in Rochester, New York.

By Mr. Zeutzius:

Q. What territory did this business cover?

A. Well, the central part of New York State, the main office in Rochester. But we did quite a bit of logging operations throughout the state, travelling saw mills. We cut second-growth timber, including white pine, second-growth white pine and hardwoods, at that time there were considerable quantities of maple, beech, and birch, ash, and so on, which in turn we supplied to the furniture factories and various other types of various other manufacturing industries, and I handled the sales and I helped supervise the [29] cutting of the timber along with shipping, incidentally, all of the crating of the material, followed and supervised all the shipments to these various manufacturing companies.

Q. Did you have any official position with the company?

A. I was secretary and treasurer of the company and a director.

Q. Over what period of time?

A. From the time about a year after I entered the business, that would be about from 1921 or approximately 1922, up until the end of the business.

Q. What compensation did you receive during those years?

A. Well, approximately anywhere from a salary of 12 to 15 thousand dollars a year, in that particular end of it, of course afterwards, shortly after I entered the business in the wholesale end I opened

(Testimony of W. J. Cunningham.)

up a retail yard, it was approximately two years after I had started in the business, which would bring us up to 1922 or 1923. Previously to that time it was wholesale. Then from wholesaling we got to retailing, and we had about ten of them.

Q. In addition to your 12 to 15 thousand dollars a year salary, what other income did you receive from the business?

A. Director's fees of \$25.00 for each and every [30] meeting.

Q. Was that the custom throughout your connection with it?

A. That was the custom throughout my connection with the company, always has been.

Q. Now, in addition to director's fees, what, if anything, did you receive by way of income from that company? Did you ever receive any dividends?

A. Dividends, yes.

Q. Did you receive any outside compensation during that same period in addition to the 12 to 15 thousand dollars and dividends?

A. Yes, I did. I was the commissioner for \$20,000,000 worth of sewer work, handling the awarding of contracts, checking the engineers' fees and the services of the engineers and the bids and the certificates of acceptance to the bank which held the funds of the township where this work was being put in, plus rendering personal services and so on.

Q. Where was this project?

A. This was in the City of Rochester, New York, and adjacent.

Q. Over approximately what years?

(Testimony of W. J. Cunningham.)

A. That would be approximately from 1924 to 1927, approximately three or four years. [31]

Q. Did they complete the project?

A. I completed the project and closed successfully, yes.

Q. What compensation did you get for that?

A. Well, I received a fee which amounted to approximately \$2,500.00 a year for the services.

Q. Now, in connection with your duties with the lumber company in that 15-year period of which you spoke, did you meet anybody that you might include in the manufacturing or business world of prominence?

A. Well, I knew everyone of prominence in the area, politically and in business. I was close to the Bausch & Lomb people, Carl Bausch, I was a close friend of Taylor of the Taylor Instrument Company, Limited. Included as one of my very good friends was the governor of the state, Al Smith, and any number of public leaders and business people. I was very active politically at one time, myself, having been county committeeman, executive committeeman.

Q. What was your contact with the foundries of which you spoke?

A. Well, we specialized in a particular type of flask lumber for them that we cut to size, in other words, there were about 15 different pieces that we cut particularly to size for flasks, and bottom boards and things of that nature for foundry work, specialized in it. We specialized in [32] pattern pine and certain types of crating lumber and heavy tim-

(Testimony of W. J. Cunningham.)

bers for people like the Baldwin Locomotive Works, and we specialized in certain types of mill work from retail yards and dealt in building supplies for building apartments and things of that sort and houses.

Q. With respect to your duties in connection with the foundry people and the type of people that you just mentioned in your last answer, what was the extent of your duties insofar as acquiring knowledge of these businesses that you visited?

A. The extent of my duties?

Q. Give us something concerning whether or not your duties were such as to enable you to learn anything concerning the foundry, pattern and other businesses.

A. Well, naturally my contacts were very close to patterns and foundries, at that time, as I stated before, I had occasion to meet not only the mechanics employed there, but I was asked on many occasions by the owners of the businesses for some advice. I very often went two or three times a week or more to the foundries and pattern shops and allied industries, so I had an opportunity to get knowledge of what was being performed in those various places.

Q. What was the extent of your travels while with the lumber company?

A. Well, I had occasion during many times to make [33] trips out on this coast to purchase material, lumber, from companies like Weyerhaeuser's, and various other big lumber concerns for our uses back East. As a matter of fact, our principal source of supply at that time for lumber for framing mater-

(Testimony of W. J. Cunningham.)

ial was Pennsylvania Hemlock and that supply was becoming limited due to the fact that, well, they were just cutting all the timber off, so there was nothing left, so our supply consisted mainly of West Coast material.

Q. Now, did the lumber business remain good at all times?

A. Well, we had a reorganization in 1932, we went through Section 77-b of the Bankruptcy Law, which I more or less sold everything that I owned to get cash sufficient for and hypothecated my insurance policies to acquire the corporation at that time which it was not necessary for me to do, but I did it.

Q. All the bills were paid?

A. All the bills were paid, everybody was paid.

Q. 100 cents on the dollar?

A. No, no, we settled for 75 cents on the dollar.

Mr. McFarland: If the Court please, the best evidence of all this is the record in the bankruptcy proceeding rather than counsel's recollection or the witness' recollection.

The Court: I understand. This is just background. It could be better evidence, of course, I agree with that.

Mr. McFarland: I think counsel ought to be cautioned also not to ask leading questions, too.

The Court: Yes, don't lead your witness. You may proceed.

The Witness: I might state, if I may, that during these periods of time I was offered many corporation positions and jobs with several companies. One of them was the Edison Portland Cement Company. Their main office is in Philadelphia.

(Testimony of W. J. Cunningham.)

Mr. McFarland: I object and ask the answer be stricken. There is no question before the witness at this time, if the court please.

The Court: Oh, well, he may complete the answer that he has started, background testimony, as I understand it.

The Witness: And further than that, a contractor who was doing approximately 40 to 50 million dollars' worth of state work a year had offered me a position at approximately the same amount for more or less of a sales promotion man, we might say.

Q. (By Mr. Zeutzius): With what company was this?

A. That is the Oliver Cost Construction Company, the other was the Edison Portland Cement Company at Philadelphia, and [35] the sales manager's name was McKelvy, if you would like to check that up, for the one, and the other company was Oliver Cost, himself, who passed away about eight years ago and died leaving an estate of about \$12,000,000.00.

Q. What compensation had you been offered by each of those?

A. Each and every case I was offered approximately \$25,000.00 a year and all my expenses in traveling and otherwise, entertainment and so on, which was customary in those days.

Q. When did that approximately occur?

A. That occurred approximately between the years 1924 to 1929, but I didn't like the position because it entailed more or less drinking and spoiled

(Testimony of W. J. Cunningham.)

my home life. I have been married 26 years and I would like to continue to be married for a number of years more, so for that reason I didn't care for these particular jobs, and I preferred to stay in business.

Q. Did you meet anyone at any time connected with the Aluminum Company of America?

A. Yes. I, of course, had done a considerable amount of business with the Gulf Refining Company of Pittsburgh and had met Dick Mellon and a number of the people, all the engineers around, supplied them with all their materials for building a big plant at Cleveland, Ohio, down in the flats. [36] I handled approximately a hundred thousand dollars a year for the Gulf Refining Company and through the Gulf I had met Dick Mellon and a number of people connected with the ALCOA and had very fine connections in there.

Q. To summarize, during the period 1920 to 1925, what is your recollection as to your earnings from all sources during the peak years?

A. I would say approximately around \$25,000.00 a year average.

Q. You mentioned you were married. How many children did you have or do you have?

A. I was married in 1920. June, I will be married 26 years, that is this June. We have three children.

Q. Is the vice-president who was excused from the room this morning your wife, Mrs. Cunningham?
A. That is correct.

(Testimony of W. J. Cunningham.)

Q. Was the name of the Bausch & Lomb Optical Company mentioned by you earlier?

A. Yes, it was. Carl Bausch, one of the owners of the company, his grandfather founded the business, is a neighbor of mine on Lake Ontario at our summer home. Ray Taylor was a neighbor on the other side.

Q. Did you ever discuss the matter of employment with that company?

A. Yes. They voluntarily came to me and offered me [37] employment at both plants, with the Bausch & Lomb Company and with the Taylor Instrument Company.

Q. Was any amount of compensation discussed?

A. No, but I would judge it would have been a fairly substantial amount. I never questioned it, because I was not interested at the time.

Q. When was that?

A. That was along about 1935, before I came out on this coast. I came out here in 1936, been out here ten years this October.

Q. When you came out here, what did you do?

A. I engaged in, took a position to keep busy at the lumber business temporarily until I could get myself located, and tried to renew some of the contacts that I had out here.

Q. Did there come a time when you met out here Withers and Ruzzamenti, referred to in the stipulation of facts?

A. Yes, sir. Well, during the time I was employed with the lumber companies, it so happened I made a call when this Westwood Ice Rink was being

(Testimony of W. J. Cunningham.)

formed out here. A man by the name of J. Frank Ruppenthal was promoting the rink. I had seen this man and talked with him quite a bit about building and general housing, and we became very friendly, and it was out there that I met Mr. Withers and Muretta and various other people connected with the undertaking, J. F. C. O'Connor, I guess he is a judge now, was one man I met in [38] this connection who handled this case for Ruppenthal afterwards, endeavoring to straighten things out. Incidentally, they had involved about \$135,000 in that case, approximately \$65,000 was with one financial interest, and I worked many months with Ruppenthal through J. F. C. O'Connor's office endeavoring to straighten the matter out for him. As a matter of fact, the suggestion was made by J. F. C. O'Connor that I take over the actual operation of it and so on, and it was during this time that I met Withers and Muretta—what the devil was the name of the corporation? I am sorry. I don't know the name of the company.

Mr. McFarland: In Westwood?

The Witness: Westwood Village.

Mr. Zeutzius: Yes.

The Witness: It was this new ice rink. I can't think of the name of it now. It is the ice rink in Westwood Village, the one Sonja Heinie played in, and they made many attempts to try to sell it to her or her agent, the same thing. She just took it in the last few months. I contacted him many times trying to sell the rink through him, but was not quite successful with him.

(Testimony of W. J. Cunningham.)

By Mr. Zeutzius:

Q. In connection with Withers, was there any conversation between you?

A. Well, the conversation veered around, we had had [39] several talks on various other affairs and he told me about having some foundry equipment, where he had loaned some money to some people and they were unsuccessful in operating the business, and he wanted to know if I had any knowledge of the foundry business, what I thought of it and so on. I told him I had some knowledge of the foundry business due to my calls on them for many years, and we discussed the matter pro and con, and we decided then, or he requested that I go and take a look at this foundry equipment and the location of it and so on, and I went over into Culver City where the equipment was located and we looked it all over, and I made the suggestion then if the environment was different, the location of the foundry were in an industrial section, it was set up properly with a capitalization of approximately a thousand dollars, that we could possibly make a successful venture out of it within a couple of years, having in mind some things I knew about that Withers didn't know about, I mean I told him about it, about all we needed was a licensing agreement and we were ready to go, in a way.

Q. Did you inspect the foundry equipment with Withers? A. I did.

Q. Where did you inspect it?

(Testimony of W. J. Cunningham.)

A. At Culver City. It was located in back of these two fellows' place, their home there where they were operating. [40]

Q. Was the equipment thereafter acquired by the petitioner?

A. It was, yes, and moved to a new location which we found.

Q. Is that the same equipment described in Paragraph 3 of the stipulation in evidence, being of the fair value of \$600.00?

A. That is right.

Q. Tell us what occurred between you and Withers after you had visited the foundry equipment, by way of creating the petitioner.

A. We decided to form a corporation, and Withers informed me that he had an attorney by the name of Bernard Laven whom I had never met, who handled Jane Withers' Affairs, the little picture actress, and that he could satisfactorily handle it, which I concluded, too, and we went down to his office and went into the details of the matter. A corporation was formed and naturally Mrs. Cunningham put in an equal amount with Withers.

Q. How much did Mrs. Cunningham put in the corporation? A. I believe \$500.00.

Q. What did she receive for it?

A. I think it consisted of 25 shares of stock, if I remember correctly. [41]

Mr. McFarland: This is all set out in the stipulation, if the court please.

Mr. Zeutzius: Yes. I think the stipulation states 50 shares.

(Testimony of W. J. Cunningham.)

Mr. McFarland: Yes. We are not relying just on his recollection. I submit that this is not necessary.

The Witness: Yes, it is about 50 shares, approximately. I was not a stockholder at any time.

By Mr. Zeutzius:

Q. Did you put any money in at that time?

A. No, I did not.

Q. How much did Mr. Withers put in?

A. The same amount, \$500.00, plus the equipment.

Q. Now, who were employed after the corporation was organized in April, 1942?

A. Well, these people called the Ruzzamentis. There was the father and two sons.

Mr. McFarland: The corporation was organized in 1940, if the court please, not 1942.

Mr. Zeutzius: Counsel, you are correct. That is my error.

The Witness: There was John and Alex and another son; I can't quite recall the other boy's name.

By Mr. Zeutzius:

Q. What was the location of the equipment at that [42] time? A. On Slauson Avenue.

Q. What did you do at that time with reference to the corporation?

A. Well, at that time after the corporation was set up, the papers being drawn, I found a location up and install the various utilities there to get it in shape to operate and made the deposits for the

(Testimony of W. J. Cunningham.)

various utility companies, in general, electrical work and water and so on, in other words, getting the building set up in shape to do business, and in the meantime during that time I was formulating and figuring out patterns which might enter in the line, brass iron andirons and other articles that we could make in there, plus some aluminum work that we were contemplating doing. We had an order—or later on, that comes into it later on, we had an order from a company called the Phone Company for making 10,000 of these little play-tune things you see in the Thrifty Drug Stores, \$1.18 apiece, an \$18,000.00 order.

Q. With respect to the year 1940, what amount of your time did you devote to the business of the petitioner corporation from the date of its incorporation?

A. Well, I put in all of my time, down to 12 and 13 hours a day, endeavoring to get business and to get things started and going, for which I received no compensation [43] whatever, spent my entire summer, as a matter of fact, lived on borrowed money.

Q. You mean during 1940?

A. That is correct, yes.

Q. By the end of 1940 what had you accomplished by way of promoting the petitioner's business?

A. By the end of 1940, well, not so much. I mean, not that I considered a very desirable picture. I mean I had done considerable work and

(Testimony of W. J. Cunningham.)

had formulated, started a lot of things and I had a lot of things, pattern designs, made and had done some business, but not any large amount. It was not entirely satisfactory as far as I was concerned. During that period of time I incidentally was working on this licensing agreement with the Aluminum Company of America, endeavoring to get that straightened out, which without you could not make these various alloys, because ALCOA had patent rights on it, and it was impossible to even buy the alloys unless you had a licensing agreement and paid the royalties on it.

Q. Now, keeping in mind the year 1941, did you draw any salary during that year? A. 1941?

Q. Yes. You said you drew none in 1940.

A. Oh, I drew, I think, approximately \$1400.00 and some-odd dollars from the corporation in 1941 for salary [44] for the services, yes.

Q. Was the amount paid you authorized by any corporate action?

A. I think so, yes. You asked me the name of that ice rink. It was the Westwood Ice Palace.

Q. What was your position with the company in 1940?

A. I was secretary and treasurer and a director—not a director—a director, yes.

Q. What was your position in 1941?

A. I was, I believe, president of the company in 1941.

Q. And what was your official position in 1942?

A. President of the corporation.

(Testimony of W. J. Cunningham.)

Q. What was your income in 1940 while you were with the company?

Mr. McFarland: I object, if the court please.

The Witness: I received no income.

The Court: I will overrule the objection.

By Mr. Zeutzius:

Q. My question is intended to include income from any source whatever. A. No, sir.

Q. What was your income from any source whatever in 1941?

A. I believe around \$1600.00 from the corporation, I believe was the amount that I got in 1941.

Q. Did you file an income tax return for 1941, so far as you recall? A. I did.

Q. For 1941? A. For 1941, yes.

Q. What was your income——

Mr. Zeutzius: Does counsel have the income tax returns for 1941 of this witness?

Mr. McFarland: They have not come to me.

By Mr. Zeutzius:

Q. What was your income in 1942 from any source whatever?

A. Other than the corporation?

Q. From all sources.

A. \$28,000.00, plus, I believe, \$250.00 in director's fees.

Q. What income taxes did you pay in 1942?

Mr. McFarland: I object.

By Mr. Zeutzius:

Q. On your income?

(Testimony of W. J. Cunningham.)

The Court: Well, you object. What is the purpose of that?

Mr. Zeutzius: I wish to show by this witness that all the income he got barring, I think \$7.00 or something from another source, came from this company as salary and [46] director's fees, and that he paid a certain tax on that.

The Court: Well, of course he did, but I can't see where that is material in this case.

Mr. Zeutzius: Well, it is our contention that in connection with the \$28,000 it was not all clear. He paid a considerable tax.

The Court: Certainly, certainly. You may show that he paid his taxes. I think the amount is irrelevant, because he would pay the same as anybody else in tax on that amount. Of course, you have brought out that point that he received something in excess of \$28,000.00 for the year 1942 and he filed an income tax return and paid taxes on that amount.

Mr. Zeutzius: And that he received no income from any other source.

The Court: Yes, he has testified to that.

The Witness: That is correct.

By Mr. Zeutzius:

Q. Now, in 1941, please state what you did in the performance of service for petitioner?

A. 1941?

Q. 1941, the year prior to the tax year.

A. Well, there was a change. I explained about Withers getting out of the picture. That occurred in 1941, did it not? [47]

(Testimony of W. J. Cunningham.)

Q. When did he get out of the picture in 1941?

A. Some time in March, as I recall, about March of 1941.

Mr. McFarland: We have that in the stipulation of facts, if the court please.

Mr. Zeutzius: That is right, it is shown in the stipulation that Withers withdrew in March.

By Mr. Zeutzius:

Q. And whom did you associate in the enterprise, or who became associated with petitioner upon the retirement of Withers?

A. Elmer D. Morse.

Q. How did he happen to become interested? Will you please tell us if you know.

A. Well, at the time I was negotiating it through J. F. C. O'Connor's office, with some client or friend of J. F. C. by the name of Smith who had married into the Walgreen family, and during the course of that time when they were considering and looking over my data I had the license agreement with ALCOA and they were looking that over and various other proposals, and through a friend of mine I was introduced to Morse, and we arranged a meeting and discussed the business of what I had and so on, and he was very anxious to become associated with me on it. As a matter of fact, I told him about this other arrangement that I had, I thought [48] I would have to take it, I thought, but he was very insistent and he said that he wanted to make this arrangement and that he would like very much for me to make my mind up

(Testimony of W. J. Cunningham.)

to do it right away. So I considered it and thought it all over and finally came to the conclusion that I needed some one of his type who knew that end of the business, that I could not do it alone, and I could not do all the business, from what I had known of similar lines of business, I had to have some one in there that knows how to figure this kind of thing that I had encountered to keep the thing going. Morse had had quite a lot of business experience and I thought he was a good man for it, and we made arrangements whereby he first became the secretary and treasurer of the company, and a director, which was consummated, I believe, in March, some time in 1941, to the best of my recollection, and from that time on our time was devoted entirely to finding a new location, as the aircraft companies and everyone else we did business with insisted that the company be set up to operate and have the men employed before the order would be given out. It had to be done. In other words, an inspection was made, and if the company thought the situation was satisfactory for their purposes, they would give you the go ahead with the purchasing engineer, and they had to be sure if the company took the order that they would be successful in providing many of these items, and if you were [49] able to meet the personnel and chemical requirements of this business, why the order was forthcoming. It was not a very easy job to get it, you might think those orders came easy, but it was not an easy job for a new company to get business

(Testimony of W. J. Cunningham.)

on aircraft parts which involved all these alloys, because, after all, during this time there were only two people that were permitted to use them, ALCOA, which had the patent rights on them and one other company called the Aluminum Alloys, so that it was practically confined to a couple of companies during a period up to about 1940, at which time there were three or four companies like myself who were given this licensing agreement, and in this licensing agreement they specified just how it should be run, specified all the heat-treating process and they provided various and sundry things which had to be determined by an engineer. There was a multitude of things to be done, equipment to be purchased and priorities to be secured. In other words, it was one hell of a hard job to do, I will tell you that frankly.

Q. Now, I wish to go back to the matter of procuring a licensing agreement in a few moments and I would like to carry through on the basis of your present testimony. First of all, what were your duties during 1942?

A. Well, I did practically everything. I did everything. I worked, I did practically all the work there of a [50] metallurgist, I was shipping clerk, I was general manager and practically everything you could think of, as far as the production end of the business was concerned. I did everything. I hired one man, the first man I hired in this building that we found on Boyle Avenue in Vernon, I hired a man who was a carpenter to fix the building up

(Testimony of W. J. Cunningham.)

and tear the partitions down, because we had to move everything to get the utilities in, to get the gas in there and to bring the electricity and the water in, the heat-treating furnaces. The building had formerly been used by a chemist from Hollywood for experimental purposes trying to make synthetic tires and there was stuff all around the place. The building was 40 by 60 feet but later on developed into a building 80 by 165 in length. And those things all had to be done, it is hard to determine, it made a multitude of engineering problems that you can't even think of in connection with starting a new business that was virtually unknown on this coast with the exception, as I said before, of the Aluminum Company of America and Aluminum Alloys.

Q. Where did the company move from the Slauson Avenue property?

A. Moved from Slauson Avenue to a location known as 5511 Boyle Avenue. In other words, Morse took one end of the town of Vernon and I looked at the other end, and we went up and down the streets like that to get a location, and this [51] was the only one in the entire city of Vernon that was available.

Q. What were the duties of Morse during 1942 after his connection with the company had started in 1941?

A. He handled the scheduling, he handled the financial end of the business, he handled the pay-rolls, he handled the office detail of all sorts and

(Testimony of W. J. Cunningham.)

descriptions, and our duties all overlapped. In other words, two people starting a business, I guess it is to be appreciated that we couldn't just sit down and say "I am going to do this; you're going to do the payroll and books and so on." Our duties overlapped. He handled the office detail and handled the various things that go into scheduling of your parts out of your foundry and so on. In other words, our duties overlapped more or less.

Q. Who handled the financing?

A. Morse.

Q. Who acted as—did the petitioner have an inspector of castings?

A. Yes, I handled that visual inspection on all castings before they were shipped to the aircraft company, and then in turn I also inspected them, the inspectors of the aircraft company inspected them and then another inspection was made when they reached the plant, so that three inspections were made on them before they came out of the [52] plant or into our machine shop.

Q. Do you know what the petitioner would have had to pay as a salary to an inspector of castings in 1942?

Mr. McFarland: I object to that question, if the court please.

Mr. Zeutzius: I think it is perfectly proper for this witness who performed the various duties to say what it would have cost if the petitioner had had to employ somebody else to perform the same job.

(Testimony of W. J. Cunningham.)

The Court: I will overrule that. He may testify.

The Witness: Well, to the best of my knowledge, it would entail a salary from \$350.00 to \$450.00 a month.

By Mr. Zeutzius:

Q. Now, did the petitioner have a superintendent of production?

A. Well, at the start in 1942 I handled the detail of that, yes.

Q. What salary would have been required to be paid if the superintendent of production had been hired by the petitioner?

Mr. McFarland: My objection goes to this entire line of questioning.

The Court: Yes, I understand. The objection is overruled.

The Witness: Well, to the best of my knowledge and [53] belief, I have known of cases of a thousand dollars a month for a good production manager, a man that understood the scheduling of parts for the aircraft industry. You see, we made at the peak of our business down to the end various and different parts of aircraft for North American, Douglas, Vultee. We shipped all of our products all over the country, to various scattered parts, and we had to get those at the scheduled period into the machine shop, and scheduled out, and you had a certain amount of time allowed to do the job.

By Mr. Zeutzius:

Q. Did the petitioner employ anyone to handle its sales promotion work?

(Testimony of W. J. Cunningham.)

A. No, none at all. I handled that.

Q. Do you know what was paid in the trade at that time?

A. Well, I know of certain cases where five per cent was paid and some cases five per cent of the gross, some cases it might have been slightly less.

Q. Five per cent of the gross sales?

A. Five per cent of the gross sales paid, and some companies from time to time employed in some cases two or three salesmen.

Q. With respect to Mr. Morse, what, in your opinion, would the petitioner have had to pay for the services such as he rendered in 1942? [54]

A. I think he was justified in every dollar that he drew out of there. He worked very hard, the same as I did. We both worked exceedingly hard and spent long hours, 12 and 14 hours a day, seven days a week in many cases, night work and all that sort of thing.

Q. Did the petitioner employ guards?

A. No, that was an item—I believe that we were the only defense plant on this Pacific Coast that did not employ guards. We were able to convince the Army and the Army Air Corps that we were capable of handling our own guard situation. In most cases companies of this type and other types had to employ uniformed guards, on which the scale was a dollar an hour. We felt confident that our force would be able to police our little plant down there, and we would have had to employ about five guards at a dollar an hour, and it was considerable

(Testimony of W. J. Cunningham.)

saving to the management to do that ourselves. As a matter of fact, I swore in eight of my employees as special deputies to handle the guard work, and it was done very successfully, so successfully that we had no difficulty in any way, shape or form.

Q. Was that swearing in of the eight of your employees as special deputies with the knowledge or approval of any of the United States officials?

A. With the approval of the Army Air Force plant protection man, Henry Cady, and with the approval of the [55] Vernon Police Department, which these men had to be deputized through, and also were given a period of training by an Army officer there in the Navy Depot.

Q. Who fixed the business policies of the petitioner from March, 1940, through 1941?

A. The board of directors.

Q. Were meetings held throughout that period?

A. That is right, and every director was in attendance each and every time. In the business being started there were many problems we were confronted with from the standpoint of improvements to all buildings and buying different equipment and various and sundry things that had to be taken into consideration.

Q. During 1941 or 1940 did the directors receive any directors' fees? A. No, sir.

Q. From 1941 did they receive any directors' fees? A. No, sir.

Q. During 1942 how much was paid in directors' fees by the petitioner to its directors?

(Testimony of W. J. Cunningham.)

A. I believe there were ten stated meetings, in which we each received \$25.00 each, a total of a thousand dollars for the four directors.

Mr. Zeutzius: Will the counsel stipulate at this point that there was actually paid to the four directors [56] referred to and mentioned in Paragraph 21 of the stipulation of facts \$250.00 to each one of them during 1942?

Mr. McFarland: I will have no objection to your introducing the checks. I don't know what their pay as directors is, and I don't want to stipulate as a fact, if you have the checks there, as you claim, I have no objection to having them introduced in evidence.

Mr. Zeutzius: I wanted to keep down the size of the record, that was all my purpose in asking for the stipulation we have asked for, and that is that each of the four persons mentioned in Paragraph 21 were issued checks totalling \$250.00 to each, dating from August 31, 1942, through December 30, 1942, inclusive.

Mr. McFarland: That is correct. I have checked the checks.

The Court: Well, I should think it would not be necessary to introduce the checks in evidence. As I understand it, the witness has testified that there were ten directors' meetings and that each director was paid \$25.00, and that the total payments aggregated \$1,000.00 for the year 1942. It seems to me that that would be all that would be necessary, if there is no evidence to the contrary,

(Testimony of W. J. Cunningham.)

the court would find that that much was paid to the directors in 1942, without the introduction of the checks.

Mr. Zeutzius: In other words, your Honor thoroughly [57] understands that makes a total of \$250.00 each.

The Court: That is to each director, and the four would make an aggregate of \$1,000.

Mr. Zeutzius: And I wish to call your Honor's attention to the fact that it is ten meetings, and those are the only meetings during the year for which they were paid.

The Court: So I understand, and I don't think it will be necessary to introduce the checks as exhibits.

Mr. Zeutzius: All right, I will refrain from doing so, your Honor.

By Mr. Zeutzius:

Q. You were one of the directors who received \$250.00 for 1942? A. That is correct.

Q. What services were rendered by you for the amount that you received as a director's fee in 1942? What services were rendered as director for the \$25.00 that you received each time?

A. Attending meetings, spending several hours at meetings, more or less outlining the policies of the company, carrying out the wishes of the board of directors after we were authorized or told what to do. In other words, if we wanted to put any improvements in on our property it was authorized by the board of directors and I carried those [58]

(Testimony of W. J. Cunningham.)

wishes out, orders from the board of directors, as they would be. Does that answer your question?

Q. Were any services performed by the other directors, to your knowledge, for the \$25.00 fees which each received?

A. Well, those people all participated in the various stages in discussing improvements, they all took a very direct interest in everything, as a matter of fact they were all very keen about it, they wanted to see the business procedure under way so they took a very close interest in it.

Mr. Zeutzius: Now, I think the stipulation makes it clearly appear that the payment of the total amount of \$56,000.00, \$28,000.00 to Mr. Morse and \$28,000.00 to the witness, Mr. Cunningham, was actually made during the year 1942 by petitioner. That, I think, is the proper construction of our stipulation of facts, is that correct, counsel?

Mr. McFarland: I am sorry. I was not listening.

Mr. Zeutzius: In other words, may I ask, there is no doubt as to the actual payment of the \$56,000.00, one half of it to each of the two officers, Morse and Cunningham?

Mr. McFarland: That is right.

The Court: Very well. It will be understood that those amounts were actually paid to the two individuals.

Mr. Zeutzius: And were actually paid during the [59] taxable year.

By Mr. Zeutzius:

Q. For what did you receive \$28,000.00 in 1942

(Testimony of W. J. Cunningham.)

from petitioner? A. Salary for services.

Q. For what did Mr. Morse receive \$28,000.00 during 1942?

A. Same thing, salary for services.

Mr. Zeutzius: I wish to direct the court's attention at this point that in the stipulation of facts it appears that in paragraph numbered 11 that the directors on January 5, 1942, adopted a resolution authorizing the payment of salary to Mr. Cunningham and Mr. Morse at the rate of \$24,000.00 for their services to each, and that that be effective as of January 1, 1942, and be paid in such installments, monthly or otherwise, as the officers might from time to time elect, and that the Exhibit 9-I of the stipulation reflects the drawings pursuant to that resolution and a subsequent resolution set forth in Paragraph 15 of the stipulation of facts wherein it was authorized by the petitioner's directors that the salaries of Mr. Cunningham and Mr. Morse be paid at the rate of \$36,000.00 for their services, and that that be effective as of September 1, 1942, and in such installments, monthly or otherwise, as the officers might from time to time elect, and that the resolutions were [60] carried into effect by withdrawals, as shown in Exhibit 9-I, and that exhibit as stipulated in Paragraph 23 being identical in all respects to the drawing account for Elmer D. Morse.

The Court: Very well.

Mr. Zeutzius: Now, barring some things I might have missed, that will conclude with the witness. I just would like to check.

(Testimony of W. J. Cunningham.)

The Court: We will recess for five minutes.

(A short recess was taken.)

The Court: You may proceed.

Mr. Zeutzius: There was one other thing I forgot to ask the witness.

The Court: Very well, Mr. Cunningham, please resume the stand.

By Mr. Zeutzius:

Q. With reference to the licensing agreements referred to in the stipulation, which were dated February 26, 1941, when and how were they obtained, very briefly?

A. Well, through my contacts with the aircraft companies endeavoring to secure business, I found they were using these processed alloys and that they were the only ones which the engineers would recognize as being suitable for aircraft construction, and I was informed at that time that if I could obtain one of those licensing agreements from [61] Alcoa, that they would consider doing business with me, so I immediately at that time started the necessary work to get them. I first contacted Bill Mellin, who was the manager of the local office of the Aluminum Company of America, and he informed me that ALCOA had not yet made up their minds as to whether or not they were going to give that licensing agreement.

Q. When was this, approximately?

A. This was about the latter part of 1939 or early part of 1940. Well, I persisted in the effort,

(Testimony of W. J. Cunningham.)

so much so that I asked Mr. Mellin if he objected to my calling him occasionally, and he said no he didn't object, and he then turned me over to a chap by the name of Joe Michaelson, and I asked him the same question, if he minded if I contacted him on certain occasions, which I proceeded to do on an average of three times a week, at 10:00 o'clock every morning I would call and say this is so and so, have you heard anything of the licensing agreement, and the usual answer was no, our Pittsburgh office hasn't made a definite decision yet as to whether or not they were going to grant any licensing agreements. Then the thought occurred to me that through my connections back East and through my wife's connections that possibly we could work the other end of it, so several letters were written to various relatives by my wife and friends of mine, and telephone calls made, and I [62] still persisted in it because I knew it was the answer to the business that I wanted to engage in, and finally after a series of long efforts and flying around and calls and various other things this licensing agreement was delivered to me at my home, that instructions were given Joe Michaelson to deliver it, that it was to be delivered to me personally and no one else, for which I was appreciative, and only after a long time and a lot of hard work we obtained it, and to be perfectly honest with you we had to have a foundry set up of a particular type or description before this license would be granted, and afterwards I became quite friendly with the Aluminum people,

(Testimony of W. J. Cunningham.)

particularly this man Joe Michaelson, who unfortunately is deceased now, but the man who took that job over told me the other day that he had made an investigation and that he saw no reason for not giving the licensing agreement to a company such as ours and he said that he was very happy to see the progress that had been made in utilizing this particular licensing agreement. That is about all I can say. It was a lot of hard work and there were many directions that we took to obtain it. Part of that matter is that other people were able to use it because of that experience, some one had done a lot of hard work in obtaining that particular agreement. It was only through the connections and friends that I had that I was able to obtain it. [63]

Q. Do you know where Mr. Elmer D. Morse is at this time?

A. Well, no. I tried to contact him myself last week and many occasions, and I even sent a man out to his summer home at Arrowhead to try to locate him, but I have not been successful. I have called his home, he is listed in the telephone book, but I have been unable to reach him. I tried many things to contact him since last week, to be here, and it is his duty to be here, frankly, I think.

Q. Is he any longer a stockholder?

A. No, he is no longer a stockholder in the corporation.

Q. Did the person you sent to Arrowhead make a report to you?

(Testimony of W. J. Cunningham.)

A. Not in writing, just a report to me that he was unable to reach him, that he was in the city, that is, in Los Angeles at his home.

Q. Is he a stockholder at the present time?

A. He is not.

Mr. McFarland: He said no.

Mr. Zeutzius: I am sorry. I wasn't sure whether I had asked him whether he any longer was or was not a stockholder. No further questions. You may cross-examine. [64]

Cross-Examination

By Mr. McFarland:

Q. Mr. Cunningham, you spoke of the availability to you of a scholarship at Colgate which came just before the last war, and which you could not take because of that. A. That is correct.

Q. By virtue of what efforts did you obtain that scholarship?

A. Well, I played professional football while I was a young fellow. Colgate was in the habit of awarding scholarships to men who were outstanding in that particular field. They had a mighty fine football team there, and I had played a little professional football when I was about that age.

Q. For your athletic ability?

A. For my athletic ability I was offered a free scholarship, that is true.

Q. Your training, of course, in grammar school and high school was general in nature?

A. That is correct.

(Testimony of W. J. Cunningham.)

Q. Was not pointed toward any specific object, was it?

A. No, it was not, not at that time, except business training which ultimately I wanted to go into.

Q. That was more or less general business training? [65]

A. That is right.

Q. Then you enlisted in the Armed Services?

A. I enlisted in the Cavalry to start with and later on changed to a machine gun battalion, and later on we were turned to a supply train.

Q. And at the end of the war you went to work for the Travelers Insurance Company?

A. Travelers Insurance Company.

Q. As a claims adjuster?

A. Claims adjuster, yes.

Q. What did you do in connection with that job?

A. Well, it was mostly nuisance claims, to be perfectly honest, being a very young chap without, you might say, any experience in the line, naturally I was given the minor claims to handle, like automobile losses and accidents.

Q. You adjusted personal liability and property damage claims in connection with automobile accidents?

A. Automobile accidents or losses, yes. I remember one time the claim of a lady who claimed she found a cockroach in her lemon pie and showed it to the manager of a restaurant, which they were our assured, and I had to make an investigation on that and a report on it, and things of that sort.

Q. And you stayed with them approximately one year?

(Testimony of W. J. Cunningham.)

A. Approximately a year, that is right. [66]

Q. Now, what was your salary, to the best of your recollection when you were working for them?

A. Oh, I would say offhand \$170.00 on top of my car expense and then the other expenses incidental to the job. As a matter of fact, I was only, to be perfectly honest with you, if you will check my age, I was about 19 years old then, a little over 19 years old, you will see when I was 20 years old, if you will check the years in between you will find out it will check out that way.

Q. How did it happen that you didn't go back and take up your schooling when you were discharged?

A. Well, because things were in rather a turmoil at the time, I didn't particularly care about it, and Army training had started me—changed my mind, perhaps, I don't know, I just didn't have any particular desire to go and finish that. At that time I wanted a business course, and frankly, my father had a very fine lumber business and I had always sort of looked forward to the time when I could engage in some type of business.

Q. Then you eventually went with your father in the lumber business?

A. In the lumber business, in the wholesale end of it, yes.

Q. I believe you testified that you started out as a salesman? [67]

A. Yes, and I was very successful, and one among other things, we bought five or ten million

(Testimony of W. J. Cunningham.)

feet of red pine crating lumber in Canada at a very low price, and as I remember we paid about \$9.00 a thousand, purchased it from, I believe, W. C. Edwards & Company, and as a matter of fact, the owner of the company is Sir Gordon Edwards, a member of Parliament, whom I know quite well. I was very successful that first year in marketing that to a trade that had never used that type of material before. I went out to find a market for it, and so much was sold, I sold ten million feet of lumber for them, and our commission in those days was \$2.00 a thousand, so you can figure out what I would have made if I had done it on a commission basis.

Q. It all went to the company?

A. It all went to the company, but I was paid a very reasonable amount for my services, though.

Q. About what were you paid?

A. Oh, I would say around—I don't know, 12 or 13 thousand dollars, something like that.

Q. That would be \$12,000.00 anyway?

A. During that year for services.

Q. Did you have any previous experience?

A. No, it was not necessary.

Q. You didn't have to be a specialist in this?

A. No, not on the selling of crating lumber to the [68] furniture people and things like that, that had never used that type of lumber before.

Q. Mr. Cunningham, I think you will agree, won't you that maybe you would not have had that favorable influence if it had not been for your father?

A. Yes, maybe so.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: I move to strike out the question and answer.

The Court: I will overrule the objection.

By Mr. McFarland:

Q. You were secretary and treasurer?

A. That is correct.

Q. During what period, roughly?

A. Oh, I think around from about three or four years after the new company was formed, the retail end of it, I went in as a vice-president of the company at the start.

Q. When was this?

A. I would say about 1923 or '24.

Q. You stated that the business, I think, went through a 77-B thereafter?

A. I stayed right there until the end of it, as a matter of fact so that I can account of at least 15 or 16 years of my time as spent on that.

Q. On this \$12,000.00 or \$15,000.00 salary that was recommended that you spoke of on direct examination—— [69]

A. Well, it wasn't all salary. It was commissions and it was other things.

Q. I was going to ask you that very thing. I want you to break down for me the amount of that total which represented salary and the amount which represented bonus.

A. Well, let's say half of it was bonus, the other half of it was commission and bonus. That is as near as I can arrive at it.

Q. Do you have any recollection other than just a general recollection?

(Testimony of W. J. Cunningham.)

A. No, a general recollection of it. There has been a lot of water over the dam since then, 26 years have elapsed, which is quite a long time. Can you recall back 26 years ago, what you did 26 years ago?

Q. I am asking you the questions.

A. I am telling you that, and that is why I must explain to you why I am telling it.

Q. I want you to be reasonably certain in your response.

A. I am reasonably certain. I would say about half salary and half commission and bonus, to the best of my recollection.

Q. And that is the relationship which prevailed throughout your connection with your father's lumber company?

A. Throughout my connection, yes, for many years. [70]

Q. In that connection, you came to know people such as Al Smith? A. Intimately.

Q. And many political figures?

A. Yes, slept with Smith at the hotel in Albany.

Q. Was this before he wore that brown derby?

A. He has always worn the brown derby, and been a hell of a nice man.

Q. Did your business give you occasion to curry favor for this political business in New York State?

A. Yes.

Q. Of course, it was your position——

A. It was my position, the business I was in, I was selling lumber to the state departments right

(Testimony of W. J. Cunningham.)

along and selling lumber to various boards, state and county and so on. There are all using considerable materials at all times, and actually I was in active personal contact with a lot of people, and I like people and I made a wide acquaintanceship. As a matter of fact, I have built up a wide acquaintance here in California, for the years it has taken. You can make a check and you can ask dozens of people that can tell you without my telling you what I have been able to accomplish.

Q. That lumber company eventually hit upon financial straits? [71]

A. Due to the business conditions, yes.

Q. That was about when?

A. After the crash, say along about 1931 and 1932, yes.

Q. What particular element caused that particular lumber company to have some trouble?

A. That was just a complete stoppage of all business of every type and description. Industry slowed down, a lot of people were unemployed, no home building of any sort or description. I can recall an instance when for a period of about 30 to 90 days there was nothing built in that area.

Q. How large a company, how many salesmen did you have in this company? Were you a stockholder?

A. No, not at the first part of it. At the last I was.

Q. Just an employee?

A. Just an employee, that is correct.

(Testimony of W. J. Cunningham.)

Q. And subsequently a stockholder?

A. Subsequently a stockholder, yes. We employed one salesman at the time other than myself.

Q. And what was the gross sales that you would show?

A. About anywhere from three-quarters of a million to 850,000 or 950,000 a year, somewhere in that neighborhood.

Q. Now, so we can make a comparison, Mr. Cunningham, are you familiar, for instance, with the Edward Hines Lumber [72] Company?

A. I know Edward Hines quite well, a Chicago man, and he has got a little goatee. Do you happen to know him?

Q. I know him, yes.

A. He wears a little goatee.

Q. During that same period what would you say his gross sales were?

A. \$50,000,000.00 a year, maybe, I don't know, 25 million. They were a big company. They are now out of business, if you recall. They went through a receivership.

Q. You were a smaller business than the Edward Hines Lumber Company?

A. Oh, yes, there were dozens of lumber companies throughout the entire country. We only, I think, had 14 retail yards, and the total population of the environment amounted to about 305,000 people.

Q. This was Rochester, New York?

A. Rochester, New York, yes.

(Testimony of W. J. Cunningham.)

Q. After that the lumber company went through 77-B, I believe you said, in 1932 or '33?

A. Yes, about that date, as I can recall, it was somewhere in that period of time. It was reorganized and then continued for a while until the year 1935.

Q. And then you finally dissolved and went out of business? [73]

A. Finally dissolved it, paid all the bills of the corporation, leaving no debts whatsoever outstanding, and as a matter of fact, as I explained to you, I even had to hypothecate my insurance policies to pay them.

Q. In this reorganization under 77-B, what was the nature of that as far as the outstanding indebtedness of the corporation was concerned?

A. Well, I think we got—you mean, what did the corporation owe in money, is that the question you asked me?

Q. Yes, I want to know, were the creditors paid in full or did they suffer losses?

A. No, they received 75 cents on the dollar.

Q. And then you came out to the West Coast?

A. I came out to the West Coast in 1936, yes, in October.

Q. You say certainly up to this time that your experience had been wholly within the lumber company for which you were working at the time?

A. Oh, no, I wouldn't say that.

Q. You were employed and you were owner and director of the company?

(Testimony of W. J. Cunningham.)

A. Yes, but I wouldn't say that wholly. After all, a man does pick up knowledge of a great many things.

Q. I am not referring to that, Mr. Cunningham. I say [74] other than just the general knowledge that you picked up from being exposed to various other businesses, you did not have any particular training or you would not devote any time, for instance, to—I believe you referred to the Baldwin Locomotive Works; you didn't work for them at any time, did you? A. Oh, no.

Q. And the only problems you would be aware of that were Baldwin's problems would be when you came in contact with them in connection with your sales to the company?

A. Oh, yes, that is correct. I talked with their engineering department, the superintendent of their plant, perhaps, or something like that. I did very little work with the purchasing department except to get the purchase order from them. We generally worked with the practical men or the technical men in the companies to do what—

Q. When you came out here to the coast, you went to work for a lumber mill?

A. No, I went to work as a salesman, let's call it that, with one of the lumber companies here—well, it was the Globe Lumber Company, as a matter of fact, calling on the studios, calling on MGM and two or three of the studios and the industry, the same type of work, I was selling the house builder.

(Testimony of W. J. Cunningham.)

Q. Practically the same type of work you were doing [75] in Rochester?

A. That is right, yes.

Q. What was your salary with the Globe Lumber Company?

A. Approximately \$270.00 a month. They don't pay very good salaries on this coast. I paid bookkeepers higher wages than that in the East.

Q. Any commission?

A. No, I wanted a commission, but they don't allow commissions out here. They have kind of an understanding which amounts to a localized trust, in other words, each company has the same price, and unless you sell at that price you are more or less ostracized. That is perfectly true, might as well admit that is what happens. So consequently they see no reason for paying a man a commission basis. As a matter of fact, I met Mr. McLeod, who was an old friend that I first knew in Toronto, Canada, and he was one of the first contacts I made here. He remembered me after a while and we discussed things and he said, "Well, you would make an ideal manager for one of our retail setups." I said, "That's fine." He said "We might discuss the matter of compensation for it." He said, "What do you expect in the line of compensation?" So I set a figure that I thought would be rather low, at \$10,000.00 a year, and the man almost fell off the chair. He said, "Well, I don't [76] get that myself." I said, "I am very sorry." So we didn't get together. I said I was in the habit of paying a book-

(Testimony of W. J. Cunningham.)

keeper that amount to keep my books, \$500.00 a month.

Q. Now, you hit upon this foundry equipment during the course of your travels around Los Angeles?

A. That is right. I was desiring to get into business for myself, because I always had been. I was not interested in a job. A job didn't interest me in any sense of the word. I was looking for a business, a permanent business that I could get in.

Q. Who owned this foundry equipment?

A. Mr. Withers, Jane Withers' father, the little picture actress, you know.

Q. He turned that equipment over for some stock in the company that you formed?

A. Yes, and also made an investment along with it of \$500.00?

Q. You didn't put any money in?

A. I did not.

Q. Did you have any money at that time?

A. No, Mrs. Cunningham made the investment on borrowed capital.

Q. What did she put in? A. \$500.00.

Q. Mr. Withers had put in \$600.00? [77]

A. No, the equipment was \$600.00, I believe, and half of the money was \$500.00.

Q. You say your wife borrowed the \$500.00 to put in?

A. Yes, we were practically—I was living at that time on borrowed money.

Q. You didn't get that stock in your name? ✓

(Testimony of W. J. Cunningham.)

A. I did not.

Q. Did your wife get some stock?

A. Yes, she had stock in the corporation.

Q. Now, I believe you spoke of having put up for the utilities, the deposits for the utilities?

A. That is right. That is customary in a new company when you don't have a credit rating.

Q. You put that up yourself? A. Oh, yes.

Q. I mean you didn't pay that out of your own personal money?

A. Right out of my personal pocket, and then later on I was reimbursed. The books will show the deposits, yes.

Q. The company paid for them in time?

A. In time, yes.

Q. When did you first come into contact with the aircraft people?

A. Oh, let's see the latter part of 1940 or the middle of 1940, I can't just exactly tell you when, somewhere [78] in that neighborhood.

Q. And some time toward the latter part of 1939 or 1940 orders began to come in from the aircraft companies, didn't they?

A. No, we had no orders whatsoever.

Q. I am not talking about your company. I am talking about the expanding aircraft industry.

A. Well, no, I don't believe they came in as early as that, still they might. Visualizing the aircraft before the war, Douglas Aircraft was building——

A. I suppose you, being a capable business man,

(Testimony of W. J. Cunningham.)

recognized the advisability of working for the companies?

A. I frankly selected that as the business that I wanted to engage in. In other words, I had no idea that there was going to be a war; if I had, I could have been a millionaire many times over. I figured that as a business that I wanted to engage in. It was a highly technical business, it was an interesting business, because you were doing a different thing each and every day.

Q. When did you first come in contact with Mr. Withers?

A. That was in about 1939, I would say, somewhere around in there.

Q. What part of 1939?

A. The early part of 1939.

Q. When did you subsequently finally conclude the [79] deal whereby Withers turned this foundry equipment over to the company?

A. Oh, somewhere in 1940. I can't recall the exact dates.

Q. And of course Germany had gone into Poland at the time, hadn't it?

A. I don't recall. I think so, yes.

Q. She invaded Poland around September, 1939.

Mr. Zeutzius: Yes, I so stipulate.

The Witness: I think so. I don't know.

By Mr. McFarland:

Q. I believe if you check the records you will find it was roughly around that.

A. That is possibly true.

(Testimony of W. J. Cunningham.)

Q. But you still didn't have an idea of going into business on account of the war?

A. No, not altogether. If I had, I would have done an entirely different, I would have done a much bigger job and made considerably more success than I made of it.

Q. Then I gather there was a little bit of luck connected with it?

A. Yes, to a certain extent.

Q. But you say the war was not in any way included in your plans or determinative of your course of action?

A. How would any one man be able to figure, then, [80] that aircraft would win the war? I mean if I had that thought in mind, I naturally would have gone into another line of endeavor. There were other things to do other than just doing a lot of hard work and a back-breaking job building a foundry. There were many easier things to go into.

Q. This was one of them?

A. Have you ever been in a foundry? Do you know the type of work it is?

Q. I am generally familiar, yes.

A. If you know, then you grasp the idea what it is all about.

Q. This Aluminum Company licensing agreement, I think you said that was obtained in 1940 or around in that time?

A. That is correct, yes.

Q. What part did your wife play in that?

A. Well, Mrs. Cunningham had a cousin, as a

(Testimony of W. J. Cunningham.)

matter of fact, who was very close in with the Mellon interests living in Pittsburgh, had a place there and employed, I don't know, 30 or 40 salesmen, knew all the people there, and we correspond with him, always did correspond with him. His name was Ed Staedt. He is down East now.

Q. What was his business?

A. He had put in all the high-power installations in the New York Tube, and various and sundry things for Westinghouse. He was Westinghouse's agent there, and that [81] incidentally is a Mellon-owned concern, owned by the Aluminum Company of America, one of their subsidiary companies, and he was very influential with the company, he was one of the people I went to. Also a brother-in-law of Mrs. Cunningham's who was the general sales manager and vice-president of Rogers Shoe Company, and various other friends, among them was Henry Carlson, chief engineer of Gulf, along with half a dozen other people. It was only through them that I was ever able—I wasn't ever a foundry man, and the Aluminum Company just don't want to give away the stuff. After all, the Aluminum Company had some reason for it.

Q. Inasmuch as you were not a foundry man, as you say?

Mr. Zeutzius: I move to strike out counsel's statement.

The Witness: I wouldn't say I wasn't a foundry man.

(Testimony of W. J. Cunningham.)

By Mr. McFarland:

Q. Didn't you just say—what was your answer? I thought you said you were not a foundry man.

A. I meant that in the sense of not a man who has been in the foundry business many years. I had foundry experience previous to the licensing agreement.

Q. What foundry experience did you have?

A. Well, operating this particular foundry previous [82] to this licensing agreement, in which we made various brass pieces.

Q. When did you begin operating this foundry?

A. We started about 1940.

Q. What month of 1940?

A. I don't recall. April, perhaps.

Q. When did you obtain this licensing agreement?

A. I don't know. The licensing agreement was there. I am not going to go by hearsay on everything. I have to refresh my memory occasionally.

Q. Would you say you obtained it in February, 1941?

A. Is that in the licensing agreement?

Q. Yes, it is.

A. It was approximately that time, yes.

Q. This was the culmination of, I believe you stated—

A. The latter part of 1939 and '40 efforts, yes.

Q. Now, the latter part of 1939 and 1940, the company was not in existence in 1939, was it?

A. Well, yes, not active, you see, but contacts had been made.

(Testimony of W. J. Cunningham.)

Q. The company did not come into existence until April of 1940, is that right?

A. That is probably a fact.

Q. So the most that it could be the culmination of [83] would be from April, 1940, to February, 1941, is that correct?

Mr. Zeutzius: I move to strike out counsel's question as being argumentative, assumes a situation in asking the question and then assumes that it could not be. In other words, it is an unfair question.

The Court: I will sustain that objection.

By Mr. McFarland:

Q. Well, Mr. Cunningham, I believe you have stated that that company, Walts, Incorporated, was organized and started doing business in April of 1940?

A. I think the records show that, yes.

Q. Your licensing agreement bears date of February 26, 1941?

A. That is correct. I believe that is true.

Q. And that licensing agreement was obtained after some period, we will say, of work to obtain it on your part and on your wife's part?

A. That is correct, that is right, a very hard effort.

Q. Now, were there expenses incurred in that connection?

A. Yes, lots of expense. As a matter of fact, borrowed money was used in most cases to keep this thing going and to keep ourselves going, and

(Testimony of W. J. Cunningham.)

which we were not reimbursed in any way, shape or form for it. [84]

Q. Did you make any expenditures on behalf of the corporation? A. Yes.

Q. Were you reimbursed for them?

A. No, never have been.

Q. Was your wife reimbursed?

A. No, never reimbursed for anything.

Q. You say she was never reimbursed for anything, excepting that licensing agreement?

A. That is correct.

Q. And now I direct your attention, Mr. Cunningham, to the minutes of the meeting of March 31, 1941, and in the body of the minutes, and I am quoting from the minutes—

A. Yes.

Q. —“Walter J. Cunningham advised the corporation had just obtained from the Aluminum Company of America, two written agreements licensing the corporation to use its heat-treating process for manufacturing aluminum alloys and products, and that the agreements were procured through the efforts of Catherine Cunningham, who incurred obligations and expenses in the sum of \$1140.00 in obtaining these agreements.” Is that right?

A. If the record so states, it is probably true, yes.

Q. Would you say this was not true?

A. No, I say that the record which you have in that [85] book is evidently true, that we wouldn't

(Testimony of W. J. Cunningham.)

have that in there unless it was true. What would be the reason for it?

Q. I am not arguing with you.

A. Let's not argue about the point.

Q. I am merely asking you a question.

A. And I am answering them.

Q. And so what you said previously is not borne out by these minutes, is it?

A. Perhaps not. I don't know. It has been a long time.

Q. As a matter of fact, in the rest of the minutes it is resolved and it provides, authorizes and directs the payment immediately of \$1140.00 to Catherine S. Cunningham to reimburse her for the monies expended for and on behalf of this corporation, and the president and secretary-treasurer are hereby directed to draw upon the funds of this corporation in accordance therewith, isn't that right?

A. If it states that in there, it is probably correct, yes.

Q. That is correct, to the best of your knowledge?

A. To the best of my knowledge, yes.

Q. And your previous testimony is not correct in that behalf?

A. Possibly not, not in every respect, and I am not to blame for that because it is quite a long time and I [86] don't recall all the incidents in connection with it.

Q. Do you recall the incident in connection with obtaining the foundry equipment?

A. Yes, certainly.

(Testimony of W. J. Cunningham.)

Q. And you were able to remember the number of square feet in the building on Boyle Avenue, is that right? A. Yes.

Q. But you don't recall other details that happened about that same time?

A. Oh, no, I recall practically everything.

Q. But you didn't recall this fact?

A. Well, you have to refresh your memory, you know. I can't just recall that transaction, no.

Q. Who had physical possession of these minutes?

A. I did, secretary-treasurer of the company.

Q. They were always available to you?

A. They were always available to me and always kept in our office safe, never out of our possession.

Q. Do you know any of the elements entering into any of this \$1140.00 that were reimbursed to your wife?

A. No, I frankly don't recall it. It is a transaction that happened some time ago, and I would have to refresh my memory. I don't just recall just what it is.

Q. After you had obtained the licensing agreement, in 1942 the Aluminum Company made that aluminum process [87] available to all in the field, isn't that right?

A. No, they did not.

Q. What did they do?

A. When, at the time we received it?

Q. No, no. Did you receive a letter from the Aluminum Company of America dated August 20, 1942, to Walts, Incorporated?

(Testimony of W. J. Cunningham.)

A. That letter I don't remember if I read the letter. I couldn't tell you whether I received that or not. I can't recall. No, you are asking me something. If you are right, I say I don't know.

Q. Have you not read this stipulation?

A. I sure have, yes, and I recall letters and other things, but I have to refresh my memory to find out whether you are right to be sure.

Q. I will gladly show it to you.

A. That is what I want to see. After all, I am not a memory expert on everything.

Q. I thought that maybe you were.

A. No, I am not. Yes, I recall this letter, quite well. That is correct. Yes.

Q. What is the sum and substance and the effect of that letter?

A. Well, all royalties were off for the duration of the war until the war was declared officially over.

Q. And the process was available to all who cared to avail themselves of it?

A. That is correct, yes. It was a government directive that where it was for war emergency uses it was available to anyone who cared to use it after that time.

Q. You were busy with war work at about that time, weren't you?

A. Yes, we were.

Q. Were all of your customers war aircraft companies at that time?

A. At that time, yes.

Q. Did you ever have an appreciable amount of non-war work?

A. Yes, some. You were not permitted to make anything but for the war effort of these particular

(Testimony of W. J. Cunningham.)

alloys, you couldn't use them in any other purpose other than it is intended for.

Q. When you obtained this agreement in 1941—

A. It was just for that one purpose, for the manufacture of aircraft parts solely for stress materials, for use where the heat-treating process had to be applied.

Q. And those parts and equipment for airplanes were on short supply at all times, weren't they?

A. Those parts were in very short supply at all times, yes. [89]

Q. At that time, around about that time, when the industry was expanding greatly?

A. I wouldn't say that exactly, no.

Q. In other words, what was the occasion that would give rise to the Aluminum Company issuing such a letter?

A. Well, I think most, more or less from the fact that a lot of pressure was brought on by the government to the effect that that was a closely held deal that they had to let out some of those licensing agreements to get away from monopoly, let us say, more or less, which they did have.

Q. They didn't have anything to do with the war effort?

A. No, I wouldn't say that.

Q. You wouldn't say that? A. No.

Q. Now, Mr. E. D. Morse, are those his initials?

A. Yes, Elmer D.

Q. He came into that business, into the company, at one time or another, didn't he? About what period of time did he enter?

A. Oh, I think it was about around March, I think, of 1941, as I recall it.

(Testimony of W. J. Cunningham.)

Q. When he entered the business he also loaned the company some \$8,500.00?

A. His wife loaned the company \$8,500.00, Dorothy M. [90] Morse.

Q. What was that for? A. A loan.

Q. For what purpose was it made?

A. To buy equipment, setting the foundry up for the purpose of using these various alloys.

Q. At that time the company did not have available \$8,500.00? A. Sufficient funds, no.

Q. To purchase this equipment on its own, it required additional capital? A. That is right.

Q. That is the reason Mr. Morse entered the business?

A. No, he came in there for the purpose of assisting me in the work that we knew would eventually become too heavy for me to handle.

Q. Prior to that time what had Mr. Morse done?

A. Well, as I remember he had owned several sporting goods stores. As a matter of fact, I believe he had three of them at that time. I think he had a series of sporting goods stores in there. He is a man that had quite a bit of financial and other experience.

Q. He had about the same knowledge of affairs as compared to yours for his end of the business, is that right? [91]

A. Yes, I had know of him and had dealings with him, and they used a considerable amount of cash to put this transaction through. He was not called in for that sole object.

(Testimony of W. J. Cunningham.)

Q. When was Mr. Morse's connection with the company terminated?

A. I believe about June of 1943.

Q. In other words, his usefulness had ended at that time?

A. No. I wouldn't say that, no.

Q. All right, what was the occasion for that, if that was not the reason why he left?

A. We are talking about 1942, I believe, and not 1943, if you don't mind.

Mr. Zeutzius: I submit, your Honor—

Mr. McFarland: I am asking the question and I would like an answer.

The Witness: I am not answering it because I—

Mr. Zeutzius: I would like to suggest to the Court that 1943 is not involved. I don't want to object to anything that may have a bearing on the case, but I think it clearly appears that Mr. Morse is no longer with the company, the witness has stated that he ceased being there in 1943, and I think any further questions are not material.

The Court: What is the object, Mr. McFarland?

Mr. McFarland: I would like to determine under what circumstances Mr. Morse left there, whether it was due to one cause or another. I think it is very material to the Court in determining what is a reasonably fair compensation for Mr. Morse. As a matter of fact, if the Court please, neither is the year 1940 involved in the proceeding, which counsel has been so zealous in getting before the Court. I don't see that I should be limited because the particular year is not now involved, when the connection

(Testimony of W. J. Cunningham.)

of the severance of the connection of this individual who was an officer of the corporation occurred in that year, for some reason which might be a reflection on the past services and have a material bearing.

Mr. Zeutzius: I submit, your Honor, that in the year subsequent to 1942 many things can happen, a man may have a breakdown in health from overwork.

Mr. McFarland: Well, if that is the situation, let it be brought out.

Mr. Zeutzius: He might have family difficulties. I am not suggesting that is the fact, I am giving it to apply abstractly to any person in the company, any number of things might happen. I think it has absolutely no bearing. The question is whether or not the man performed certain services during the taxable period, what he actually did and what his abilities were then, not what they might [93] have been thereafter.

The Court: I don't see, unless you can relate some incidents that you expect to prove as to him, I can't see where it would be relevant as to why he terminated his connection with the company in 1943, which is the year following the taxable year. What do you expect to show that would be material in that respect?

Mr. McFarland: If your Honor please, I have no idea what the proof would show on this.

The Court: Well, I will sustain the objection, then. The relevant year is 1942, and what services Morse performed, what he was paid for it and things of that kind, in 1942.

(Testimony of W. J. Cunningham.)

Mr. McFarland: Will reference to the year 1940 be treated in the same fashion?

The Court: Well, except for the background and experience and so on. We like to be pretty lenient about that, you know.

Mr. McFarland: I see.

By Mr. McFarland:

Q. The sales of the company increased greatly, didn't they, throughout 1941 and throughout 1942?

A. Throughout 1941, I believe that the volume of approximately of 9,000 in 1941 to 128,000 in 1941, I don't recall the figures offhand. [94]

Q. I believe your records show that your sales increased, that in August of 1931—

Mr. Zeutzus: 1941.

By Mr. McFarland:

Q. 1941, I stand corrected, your sales were in the amount of approximately \$7,200.00, and by the end of the year they had increased to \$39,000.00?

Mr. Zeutzus: For the whole year, counsel.

By Mr. McFarland:

Q. That is cumulative for that year?

A. That is right.

Q. And the sales by months ranged from \$7,200.00 on August 31st to about \$13,000.00 on December 31, 1941?

A. Yes, probably the records show that.

Q. And in 1942 they raised spectacularly, didn't they? A. I don't recall the monthly figures.

Q. What was your gross sales volume?

A. Approximately \$470,000.00, I would say, off-hand, for 1942.

(Testimony of W. J. Cunningham.)

Q. What proportion of that was due to your sales to the aircraft companies?

A. What proportion of that was sales to the aircraft companies?

Q. Yes. [95] A. All of it.

Q. All of it? A. Yes, sure.

Q. You didn't have any business with any other industry?

A. You couldn't do business with any other industry, the war effort would not permit you to do it. You could not sell commercial aluminum to anyone throughout the war period. You had to ask the military authorities for permission. Anyone who did that, if I did it, I would have been in jail. You couldn't get any aluminum, all that you purchased had to be used for building aircraft. You had to bring in your purchase orders and specify how much aluminum you needed for the work and schedule your raw materials before you could receive it. So there was absolutely no way of getting any other material in. You were issued just your requirements for your aircraft companies. There was no other way of doing it.

Q. Mr. Cunningham, the company at no time paid dividends? A. Never.

Q. And never even discussed the feasibility?

A. Well, we talked about the feasibility of paying dividends.

Q. When did you talk about that? [96]

A. I don't know. In 1942 we discussed it.

Q. Who discussed it?

A. The directors of the company and officers.

Q. In directors' meetings?

(Testimony of W. J. Cunningham.)

A. Sure, we discussed it in informal discussion, never entered on the record.

Q. Never got in the records at all?

A. No.

Q. And the company never did pay dividends at any time? A. No.

Mr. Zeutzius: Now, I submit, I move to strike out the question and answer. I think it should be limited to any time between the incorporation and the end of the current taxable year involved, because that involves—

The Court: I deny the motion to strike, and the answer can stand.

Mr. Zeutzius: In taking the exception, I would like to call your Honor's attention to this, if the evidence is permitted to go beyond the taxable year, it involves or may involve unfair inferences unless we be permitted to show all the facts that occurred subsequent to the taxable year.

The Court: We will just confine it to 1942. No dividends were paid in 1942.

Mr. Zeutzius: Thank you, your Honor. [97]

The Court: The rest will be stricken.

Mr. McFarland: Do you care to amend the stipulation of facts, counsel?

Mr. Zeutzius: No, I am satisfied that the stipulation of facts will show it is perfectly true that from the time they were incorporated in 1940 through 1942 no dividends were paid. Is that what you want?

Mr. McFarland: That is shown, I believe, by the stipulation of facts.

The Court: The stipulation still stands.

Mr. Zeutzius: I think it is a fair stipulation.

(Testimony of W. J. Cunningham.)

Mr. McFarland: I just don't understand what—

The Court: What he is objecting to is any testimony that no dividends were paid subsequent to 1942, as I understand it.

Mr. Zeutzius: That is correct.

The Court: I will sustain that.

Mr. McFarland: Very well.

By Mr. McFarland:

Q. Mr. Cunningham, at no time—am I right when I make this statement—did you ever contribute financially to the company? A. Never.

Q. Never? A. No. [98]

Q. You have never been a stockholder for that matter, have you?

A. Not during that period, no.

Q. Subsequently you did own some stock, is that right?

A. I am referring to 1942. I was not a stockholder in 1942.

Q. Were you a stockholder in 1941?

A. No.

Q. Were you a stockholder in 1940?

A. No.

Mr. Zeutzius: The answer is not as to all three years.

The Witness: That is correct.

By Mr. McFarland:

Q. At all times the corporation obtained credit elsewhere than by your individual resources?

A. Yes.

Q. Now, tell me what yardstick did the corporation use to determine the amount of salaries that it was going to pay to you and to Mr. Morse? And I

(Testimony of W. J. Cunningham.)

am referring specifically to the minutes of January 5, 1941, wherein it is stated that notwithstanding any action heretofore taken by the board of directors by resolutions or otherwise, the president, Walter J. Cunningham, is to be paid at the rate [99] of \$24,000.00 a year for his services and the secretary-treasurer, E. D. Morse, is to be paid at the rate of \$24,000.00 for his services? How did you determine 24,000? Why not 23 or 25?

A. The reason, for past experience and performances I believe that was, they said I was just entitled to that amount of money.

Q. Well, past experience and performances, what do you mean by that?

A. Well, previous years that we were in the company.

Q. Previous to January 5, 1942, is the basis of this action? A. I wouldn't say that, no.

Q. Well, the meeting was held January 5, 1942.

A. Yes.

Q. Now, you certainly were not taking into consideration what might occur subsequent to January 5, 1942? A. No.

Q. You were not considering that at all?

A. No, we just took it as compared to other industries or other people in the same line of business.

Q. You were not considering what would occur subsequent to January 5, 1942?

Mr. Zeutzius: Are you asking the witness what he considered or are you asking him to speak for the other [100] directors as well?

Mr. McFarland: I am asking what he considered.

(Testimony of W. J. Cunningham.)

If he can speak for the other directors, I am very glad to have that.

The Witness: No, I can't speak for the other directors. I speak merely for myself. I don't know. It is rather difficult for me to answer.

By Mr. McFarland:

Q. You could not answer that? A. No.

Q. I believe you said that your gross sales in 1941 were approximately \$30,996.19?

A. Well, we have the record there. I can verify it by—

Q. On that basis you still earned \$24,000.00, for both you and Mr. Morse?

A. Well, I don't know, perhaps we took into consideration previous work that had been done in forming the corporation, and then we might have considered that we received no compensation for those years of working at it, we might have taken that into consideration.

Q. And I believe at that time the surplus of the company, the earned surplus of the company amounted to \$38.46? A. At which time? [101]

Q. On December 31, 1941, just five days before January 5, 1942, amounted to \$38.46.

A. Possibly.

Q. And the next year the company added to earned surplus approximately \$9,000.00?

A. Yes, that is true, probably. The figures are all there.

Q. Now, I direct your attention to August 28, 1942, and I read a portion of the minutes of that directors' meeting. It says, "Resolved, that notwithstanding any action heretofore taken by the board

(Testimony of W. J. Cunningham.)

of directors, by resolution or otherwise, that President Walter J. Cunningham be paid at the rate of \$36,000.00 per year for his services and that Secretary and Treasurer E. D. Morse be paid at the rate of \$36,000.00 per year for his services." You recollect that meeting, don't you?

A. Yes, I recall that very well.

Q. Now, your sales from January, 1942, to August of 1942 increased from \$11,000 to \$170,000. That is what the records show? A. Yes.

Q. Did that have any bearing or not?

A. Possibly so, yes. You are entitled to additional compensation, I believe, I mean under the laws of the land.

Q. I am not arguing. I am just asking you and [102] attempting to find out the facts, Mr. Cunningham. I was not present at this meeting.

A. I understand you were not present, yes.

Q. I don't know what transpired in that meeting.

A. Oh, yes, the minutes show what transpired. This is your minute, isn't it? This is the record of that meeting right in there.

Q. And that is the only considerations that were involved, insofar as you were concerned?

A. As far as I am concerned, yes.

Mr. McFarland: If the Court please, I don't know whether you care to have me offer now or later these minutes. I would like to introduce as exhibits in evidence three minutes, March 31, 1941, January 5, 1942, and August 28, 1942.

The Court: I think you might as well do it at this point, Mr. McFarland.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: May I say this: I loaned counsel this minute book. We don't want it out of our possession, except for the purpose of photostating.

The Court: Yes, you may substitute photostats.

Mr. McFarland: Yes, we will substitute photostats.

Mr. Zeutzius: In other words, I don't want it to get out, sir. [103]

Mr. McFarland: We will offer them and make photostats and substitute the photostats.

The Witness: That is right, we don't want to lose our minute book.

The Court: Counsel will make photostats from the minutes that are offered and then return it to you.

Mr. Zeutzius: Fine.

The Court: Will you identify them one by one, Mr. McFarland?

Mr. McFarland: I offer as Respondent's Exhibit L minutes of the special meeting of the board of directors of petitioner held on March 31, 1941.

The Court: That will be received as Respondent's Exhibit L.

(The minutes referred to were marked and received in evidence as Respondent's Exhibit L.)

Mr. McFarland: And I offer as Respondent's Exhibit M the minutes of the meeting of the board of directors of Walts, Incorporated, held on January 5, 1942.

The Court: That will be received as Respondent's Exhibit M.

(Testimony of W. J. Cunningham.)

(The minutes referred to were marked and received in evidence as Respondent's Exhibit M.)

Mr. McFarland: I offer as Respondent's Exhibit N the minutes of the meeting of the board of directors of [104] petitioner held on August 28, 1942.

The Court: That will be received as Respondent's Exhibit N.

(The minutes referred to were marked and received in evidence as Respondent's Exhibit N.)

Mr. McFarland: And respondent at this time asks to substitute photostats for the originals.

Mr. Zeutzius: May I ask the object of offering these particular minutes? Because that puts the petitioner in this position, that I must request the Court to give consideration to practically every statement that is contained in that, so it puts us in the position of having to offer all the minutes.

The Court: Well, I think that inasmuch as the question of salaries is involved that it would be relevant to show that authorization. I don't know what additional evidence you will put in, but it seems to me that those particular minutes would be relevant evidence. You may inquire about that, of course, and introduce any circumstances in connection with them and so on.

Mr. McFarland: I have no objection if the petitioner so desires, to putting the whole minute book in.

The Court: Well, the Court would not want to wade through the whole book of the corporation.

Mr. McFarland: That is the reason I eliminated

(Testimony of W. J. Cunningham.)

the rest of them, the rest of the bulky records which have no particular bearing on the subject-matter of the controversy.

Mr. Zeutzius: For instance, the minutes of August 14 have not been offered. They include a resolution authorizing the payment of directors' fees.

The Court: Well, you can put them in.

Mr. McFarland: Surely, he can put them in.

Mr. Zeutzius: I might make my offer, if the Court please.

The Court: Yes, unless you want to offer them later on.

Mr. Zeutzius: Very well.

By Mr. McFarland:

Q. Now, Mr. Cunningham, have you ever heard of the Emergency Price Act of 1942? A. Yes.

Q. Do you recall when that became effective?

A. No, I don't.

Q. What did that Price Act bear upon?

A. I don't know, you will have to give me that.

Mr. Zeutzius: I submit—

The Witness: We are going into something here now that you— [106]

The Court: If you don't know, you just say you don't know and that is all there is to it.

Mr. Zeutzius: I submit the question is one which should be asked of an attorney.

The Court: Well, he said he didn't know.

Mr. McFarland: He has answered he doesn't know. May I have just a minute, if the Court please, to go over my notes? I believe that is all of this witness.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: First of all, the petitioner offers the minutes of August 14, 1942.

The Court: The petitioner offers in evidence the minutes of August 14, 1942. It will be received as Petitioner's Exhibit No. 11, and permission is granted to substitute a photostat copy.

(The minutes referred to were marked and received in evidence as Petitioner's Exhibit No. 11.)

Mr. Zeutzius: During the lunch hour I shall try to go through and see if there are other exhibits.

The Court: You may.

Redirect Examination

By Mr. Zeutzius:

Q. Mr. Cunningham, did you ever use your automobile in the company's business?

A. Yes, on all occasions.

Q. Did you always receive reimbursement? [107]

A. No.

Q. On that cross-examination you were asked concerning whether you ever put any money into the company for which you were not reimbursed or in substance to that effect.

A. Yes, well—

Q. Is that a correct answer, that you did not?

Mr. McFarland: Let's not ask him to answer, if the Court please. He could not answer. I don't know what the exact wording of the answer was, and I submit at this point it is not a proper question. I object to it.

The Court: Well, I will overrule the objection.

By Mr. Zeutzius:

Q. Do you recall—did you mean by your answer—Just what did you mean by your answer?

(Testimony of W. J. Cunningham.)

A. Well, I don't know. I did spend sums of money from time to time which I never kept a record of, for the helping of the corporation, yes, but I never kept records of it. I mean, I could not verify it in any way, shape or form, if that is the answer you want. I don't know those dates. I can't tell you of it. I mean a person does everything he possibly can to get going, he doesn't think so much of those things.

Q. You were asked concerning your knowledge of the foundry business on cross-examination. When the petitioner started, did you employ experts in the foundry business? [108]

A. I did not.

Q. Were experts, were skilled workmen of any sort employed?

A. They were not available. They had to be trained. Each man had to be trained separately for his job.

Q. What are some of the workers' jobs which require skill in connection with the foundry business that was operated during 1942 by petitioner?

A. Well, grinders, for instance, is an item for which the men had to be trained separately for it. We have what we call a casting line. On a casting you have to grind your casting completely on a tolerance. The aircraft companies will not use it if there is not enough so-called meat on it to machine off, but each casting had a different line, there wasn't one casting that looked alike, they were all different, so far as sizes, some have curves in, others don't have curves in.

Q. What were some of the others in addition to the individuals you have mentioned?

(Testimony of W. J. Cunningham.)

A. Grinders?

Q. Grinders.

A. All right, we have molders. Molders were available out of the iron industry. I don't think on this whole Pacific Coast there were 50 men who were experienced molders in the aluminum work. We had to bring molders in from the [109] iron shops.

Q. Were they trained?

A. They were trained in certain respects to make a mold, yes, with your risers and gates which are similar to the ordinary type of iron mold, but we had to do a good many experiments with those to find out just where your gate should be, you had to know your metal, and we had to coach them and train them in the business, in that field.

Q. Did anyone in the petitioner's plant train all these workmen to perform their jobs?

A. Well, we worked together. I mean, they probably assisted one another and got trained along with what they taught. I can't explain it any different.

Q. Were there persons known as core makers?

A. Oh, yes.

Q. Who trained them?

A. Well, core makers were in a little different category. There were ones that you could train and there were core makers that had been in that line of industry only with iron. Core makers were plentiful. It is not as difficult a job as a molder. There is nothing difficult about it.

Q. Take your patterns.

A. Pattern equipment had to be made and produced and gates put on properly so that your castings would result properly. We had to get a great

(Testimony of W. J. Cunningham.)

deal of information in [110] connection with that.

Q. Who took charge of that? A. I did.

Q. How many employees did you have during 1942, roughly?

A. Oh, I would say roughly 55 to 65, off and on. There were generally 10 to 15 per cent changing around. They came in one day and they quit the next.

Mr. Zeutzius: On direct examination I asked him to detail some of the different duties he performed. I forgot to ask him what the company would have had to pay for a job in there called metallurgist. I would like to revert back now to direct examination for just a couple of questions.

The Witness: Let's put it this way, that we had very few salaried people working for the company, and most of them took care of a number of duties in the early days. Let's say we take the job of a shipping clerk, at \$1.15 to \$1.20 an hour and that required certain duties, and in those days I handled that at all times and spent from two to four hours a day, because we had to make that shipping division of the corporation's business work, and we not only had to get out the castings but they had to be shipped and sent to the different companies. I did everything to secure and hold business. The airplane companies insisted that each [111] lot of metal poured be handled separately and a sample made for testing and the castings would have to correspond to the sample, and we had to keep track of the heat in the furnace that was carried through, had to report to the aircraft companies any differences in the process, and everything had to correspond.

(Testimony of W. J. Cunningham.)

Q. Who performed those duties in the shop along in 1942? A. I did most of them.

Q. You stated, I believe, on direct that you did metallurgy as well?

A. I had some very fine books on metallurgy that I obtained, and these men came around to check up, I gathered all the knowledge that I could from studying and asking questions of the men. Of course, naturally, that I did on my own.

Q. When did you do this studying?

A. Right at the early period, shortly after we received the licensing agreement.

Q. Did petitioner employ a metallurgist?

A. No, we did not.

Q. What would petitioner have had to pay a metallurgist for the duties that you performed in 1942?

A. Well, let's take the Aluminum Company, for instance, who were so notorious for low pay. They paid one [112] man about \$55.00 a week, Lee Payne. He is available, we can call him and I think Lee Payne will tell you that is about what he is making now. He has been with the company about 15 years at least. It is very low pay there.

Q. Who occupied the position of invoice clerk?

A. Well, sir, I did temporarily at the start, but it was rather a difficult thing, because everyone around there worked in on those things, and I was practically the only one at the start of the business who understood the handling of all that detail.

Mr. Zeutzius: I am not sure that I recall the exact state of the record with respect to the amount of taxes Mr. Cunningham paid for 1942. I don't know whether the record shows what the amount was, or whether it was ruled out. Do you recall?

(Testimony of W. J. Cunningham.)

The Court: You stated that if the testimony was admitted, it would show that on his individual income tax return he returned these amounts for the taxable year on his income tax return. I sustained the objection, as I did not consider that as relevant, and you excepted to it.

Mr. Zeutzius: May I in addition to taking an exception make an offer of proof?

The Court: You may if you want to.

Mr. Zeutzius: That proof would show that Mr. Cunningham and his wife filed separate returns on an [113] individual property basis, that a total compensation was reported of salary of \$28,000.00 and the directors' fees and an auto allowance, which aggregated \$29,015.00, \$29,615.50.

The Court: Gross income.

Mr. Zeutzius: Gross income, yes. The director's fee was also set at \$500.00, so that the gross income would be \$29,015.50, and that total taxes were paid thereon of \$3,866.88.

The Court: Very well, it will be noted in the record that petitioner offers these amounts paid by Mr. and Mrs. Cunningham, which you object to.

Mr. McFarland: I object, if the Court please.

The Court: And the Court sustains that objection because the Court considers that not relevant and not material, to which the petitioner excepts.

Mr. Zeutzius: Thank you, your Honor.

The Court: Well, have you about concluded?

Mr. Zeutzius: Just about one more matter.

By Mr. Zeutzius:

Q. With respect to the amounts which are referred to in the two resolutions fixing the salaries of

(Testimony of W. J. Cunningham.)

yourself and Mr. Morse, was it your opinion at the time of the passage of those resolutions that the amounts fixed were fair and reasonable for the services performed by either of you during 1942? [114]

Mr. McFarland: I object, if the Court please, to that question.

The Court: I will overrule the objection.

The Witness: We did not consider those salaries any too high, in view of what we had done in past times, and everything else, we did not consider the salaries as set too high a figure. We thought that was a normal procedure.

By Mr. Zeutzius:

Q. Did you consider them fair and reasonable?

A. Fair and reasonable.

Mr. McFarland: Object to leading questions, if the Court please.

Mr. Zeutzius: That was a direct question and trying to get a direct answer.

The Court: I think that, of course, in the final analysis is what the Court has to decide, but I have always ruled in these cases where salaries were fixed that they have a right to give their opinion as to whether they were reasonable or not, and he has given his opinion.

By Mr. Zeutzius:

Q. Can you recall whether the other directors by their discussions at the two meetings at which the salaries were fixed during 1942 stated, or in substance stated, whether or not they considered the salaries as fixed as fair and reasonable? [115]

A. We did, yes, in view of the fact of all the hard work that we had done during the past, and

(Testimony of W. J. Cunningham.)

of course if they had not considered them fair and reasonable compensation they would not have voted for them.

Q. Did you or did you not intend at the time of the passing of those resolutions to cause the salaries ordered and authorized to be in the nature of a withdrawal of profits in lieu of dividends declared?

Mr. McFarland: That question I object to, if the Court please, on the ground it is clearly leading, and secondly, it is another element of fact that the Court is called upon to decide.

The Court: I think a better question would be, if the one part of his objection is sustained, which is that it is a leading question, I think a better question would be, did the directors have any other purpose in mind when they directed that these salaries be paid than to pay compensation for the services.

Mr. Zeutzius: I would like to adopt the Court's question. Will you answer that question? Do you understand the question?

The Witness: Well, no, I don't quite get it, frankly. There is no such question. I don't know what you're driving at, I mean the question was so complicated. I mean, I am a layman, I am not an attorney. [116]

The Court: Well, let me put the question. The point is simply this: The Commissioner's contention is that the salaries were made higher in order that a dividend distribution be made to the corporation, in reduction of the dividend distributed. Now, the question is, when you authorized these two salaries, as I understand of \$28,000.00 to you and \$28,000.00

(Testimony of W. J. Cunningham.)

to Mr. Morse and then in August you authorized \$36,000.00 to you and \$36,000.00 to Mr. Morse, when you authorized them, did you have in mind anything else except the authorizing of compensation?

The Witness: No, I don't think so.

Mr. McFarland: That answers it.

The Court: We will recess now until 2:00 o'clock.

(Whereupon, at 12:45 p.m., a recess was taken until 2:00 p.m. of the same day.) [117]

Afternoon Session—2:00 p.m.

The Court: You may proceed.

Mr. Zeutzius: May it please the Court, I have two witnesses who are rather busy individuals, and with the Court's permission and counsel's permission, I would like to put them on out of order at this time.

Mr. McFarland: No objection. I have just a few questions of Mr. Cunningham. If counsel cares to take them out of order—is that what you wanted to do?

Mr. Zeutzius: Yes.

Mr. McFarland: I have no objection.

Mr. Zeutzius: Will you call Mr. White? Mr. White, will you take the stand?

ERNEST S. WHITE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Ernest S. White?

A. Right.

(Testimony of Ernest S. White.)

Q. Will you state your age? A. 43.

Mr. McFarland: If the Court please, Mr. White was in the court room this morning, and I move that he be [118] disqualified on the ground of the prior motion excluding the witnesses from the court room.

By Mr. Zeutzius:

Q. Were you in the court room this morning, Mr. White? A. Yes, I was.

Q. For how long?

A. Oh, I would say for about possibly 40 minutes.

Q. A little before noon adjournment?

A. Yes.

Mr. Zeutzius: I didn't know the witness was in the court room, but of course there is that ruling, though, your Honor, and—

The Court: What is the purpose? What do you except him to testify to?

Mr. Zeutzius: Just to show that he is a foundry man and is familiar with what is paid for certain jobs during the period in question, some of the types of jobs that were performed by Mr. Cunningham. However, I submit the matter to your Honor for your Honor's ruling. I didn't know the witness was in the room, and had no reason—

The Court: He is not going to testify to any point of information about the petitioner's business, is he?

Mr. Zeutzius: Well, he was familiar with the petitioner's business at the time. He represented others [119] who dealt with the petitioner, had dealings with the petitioner.

(Testimony of Ernest S. White.)

The Court: Well, inasmuch as we have the rule, I am afraid we will have to sustain the objection.

Mr. Zeutzius: Well, I make an offer of proof, that by this witness we would expect to show that a production man, we understand, in another foundry here in town during approximately the same period as is involved got a thousand dollars a month for merely handling the production work, and in another instance a man was paid \$1,500.00 a month by the same concern for just the superintendent of the foundry part of the plant, sort of a foreman, and another individual was paid as a salesman for the same company \$8,000.00 a month, less expenses, just for selling. We would expect to show that another individual who was just the office manager received in a plant of comparable size \$24,000.00 a year at about the time in question; another man in a competitive institution as a foundry superintendent received \$18,500 a year as a part owner, and he was just the foundry superintendent, and we would also show that this witness received up to ten per cent on net sales as his compensation during the last several years in the foundry business on sales made by him. We would show that he is familiar with the foundry business, and he acted as a salesman or on the production sales end; that in the trade it was common to pay, [120] among other things, five per cent of gross sales made by a man. We think that that evidence would especially tend to justify in its entirety what occurred in the evidence so far in behalf of the petitioner in connection with the resolutions for the salaries authorized and actually paid to Mr. Cun-

(Testimony of Ernest S. White.)

ningham and Mr. Morse. I think that concludes the offer.

The Court: How long were you in the court room this morning?

The Witness: Oh, possibly 40 minutes.

The Court: What time did you come in?

The Witness: About around 10:00 o'clock.

The Court: Then you went out again?

The Witness: Well, maybe I was wrong there, on the time. I went out during recess, whatever time that was.

The Court: Well, I think in view of the fact that most of the testimony you seek to offer was with respect to comparable salaries in other concerns, that I probably will be willing to waive the fact that this witness was in the court room and let him testify.

Mr. McFarland: May an exception be noted?

Mr. Zeutzius: What is your occupation?

The Court: Pardon me. Be sure to watch out now that any witness you want to use is not in the court room, because we don't want this occasion to arise.

Mr. Zeutzius: Will the Court ask if there is any [121] witness for Walts, Inc., in the court room? Anybody here subpoenaed as a witness in the Walts, Inc., case now on trial?

The Court: Apparently not. Now you may proceed.

By Mr. Zeutzius:

Q. What is your occupation?

A. Foundry owner, foundry man.

Q. For how long have you been in the foundry business? A. Well, close to 20 years.

(Testimony of Ernest S. White.)

Q. At the present time what is your connection with the foundry business?

A. I am the owner.

Q. Of what? A. E. S. White Company.

Q. That is a sole proprietorship?

A. That is right.

Q. Now, during the period in question, which is roughly 1940, 1941, 1942, during your war years all through 1942, by whom were you employed?

A. By the Aluminum Company of America.

Q. And did there come a time—in what capacity?

A. Production manager.

Q. Were there many production managers in that concern? [122] A. No.

Q. What were your duties as production manager?

A. Well, I had approximately 50 employees under my direct supervision, and it was our job to take in the purchase orders, send them out throughout the plant, expediting and priorities and so on and so forth, make deliveries, see that they got proper priorities from the various government agencies and so on and so forth.

Q. What salary did you receive for that position?

A. At that time I was drawing around 350 a month.

Q. Was that raised? A. How?

Q. Was that increased at any time?

A. No, because I left there soon thereafter.

Q. Why did you leave?

A. Well, because I heard that these different

(Testimony of Ernest S. White.)

plants around town that you heard about were beginning to pay some big money, so I went out after it myself. As a matter of fact, I started Valves, Incorporated, at that time.

Q. You were originally with Valves, Incorporated?

A. Valves, Incorporated, which is now the Aluminum Casting Company.

Q. And how many stockholders were there?

A. There were six of us.

Q. Were all six of you active? [123]

A. Yes.

Q. And what salaries were paid to the six individuals?

A. Well, we set our salaries at the time at 10,000.

Q. For each of the six? A. That is right.

Q. And what were the duties of each of the six, very briefly?

A. Well, we each had a particular job to do in the plant, and I was to handle all the outside contacts, like sales, and one of the members was the office manager and accountant, and another was the plant superintendant, then there was the foundry foreman, the core room foreman and the trimming department foreman, totalling six.

Q. Each of them, his salary was fixed at \$10,000.00? A. That is right.

Q. Now, did there come a time when you were no longer with the Valves—what was that?

A. Valves Castings, Incorporated.

Q. Valves Castings, Incorporated?

A. Yes, sir.

(Testimony of Ernest S. White.)

Q. Did there come a time when you were no longer connected with them? A. That is right.

Q. When was that?

A. The latter part of 1943. [124]

Q. Then where did you go?

A. Well, I took a vacation for myself. I had a nervous breakdown.

Q. Occasioned by what?

A. To overwork and worry and so on and so forth.

Q. Where did you go after you recuperated?

A. I swore I would never go back to the foundry business again, and I went into the furniture business and worked for Harry Gladstone out on Wilshire Boulevard.

Q. When did you next go back in the foundry business?

A. Then this Valves, Incorporated, had some trouble about their priority and going broke and so on and so forth, so they contacted me and wanted to know if I wanted to go back in it, so in February of last year I went back into the foundry business again.

Q. With what company?

A. With the Aluminum Casting Company, which was prior to that time Valves and Castings, Incorporated.

Q. Is that a corporation?

A. No, it is a company now.

Q. Now, in connection with your work at Alcoa, did that occur during 1942 and that period?

A. I don't get that.

(Testimony of Ernest S. White.)

Q. Your employment with the Aluminum Company of America, was that during the year 1942?

A. Yes, and prior to that for 11 years.

Q. Did you at that time become acquainted with Mr. Cunningham of the petitioner corporation?

A. Right.

Q. Walts, Inc.? A. Yes.

Q. What was the occasion of your becoming acquainted with Mr. Cunningham?

A. Well, through engineering purposes and foundry practice in general. He wanted some advice, and I had met him through a mutual friend, so I would go over there once in a while and give him a hand to help him get some of these jobs through and so on and so forth.

Q. Was that in your capacity with the Aluminum Company? A. No.

Q. Now, during that time had you occasion to contact other foundries engaged in aluminum casting work, in 1942 and thereafter?

A. Well, yes and—yes.

Q. Did you learn what were the salaries and compensations paid for such jobs as superintendent of the foundry part of a plant? A. Yes.

Q. In this area? [126]

Mr. McFarland: If the Court please, I object to this line of questioning, because this witness is not testifying from comparative companies. We have no yardstick by which to compare whatever salary presumably he is going to testify to for this particular job. I don't think it would serve any useful purpose.

The Court: I think that if you wish to prove the

(Testimony of Ernest S. White.)

salaries that any other corporation pays you would have to show that the business was comparable to this one and that the duties of the position were at least in some respects comparable. Now, you have interrogated this witness about different compensations that he has received in different capacities, and for him to testify as to compensation paid others, why, I think it would only be useful if it be shown that the businesses were at least in some reasonable degree comparable.

By Mr. Zeutzius:

Q. Do you know something of the size of the business of the petitioner during 1942?

A. Yes.

Q. How did you acquire the knowledge?

A. Well, I used to go in there once in a while and I saw the increase in plant capacity and I thought at the time, I still think right now, it was a pretty fair-sized concern. [127]

Q. Now, you are referring to 1942, about?

A. That is right.

Q. Do you know of any other plant around town about that time that was of similar size?

A. Well, in 1942 there were about two others of about the same size.

Q. What were they?

A. The R. H. Osbrink Manufacturing Company and Aluminum Alloys.

Q. Do you know what positions, who occupied positions there which were comparable, which involved duties comparable to those performed by either of the two officers, Elmer D. Morse or Mr. Walter J. Cunningham?

(Testimony of Ernest S. White.)

A. I didn't know them all personally, as a matter of fact, I can't recall their names, but I do know that there was two in the Osbrink foundry, and there were two also in the Aluminum Castings Company, and I just recall that at that time Socal began to form at that time, Socal Foundry, and they had any number of men doing the same jobs. They had salesmen, they had production managers, foremen, and superintendents, and everything, and that is one company that grew like leaps and bounds. They really went to town.

Q. Do you know what salaries they paid with respect to the production manager they had?

A. Yes. [128]

Mr. McFarland: My objection to this question is, if the Court please, I do not believe the witness has qualified himself to give the facts of his own knowledge, that he knew what they paid. I have no objection to that if he can state the source of his knowledge, but from what he has testified so far it is obvious—

The Court: You may inquire and test him out on that, Mr. McFarland, what his source of knowledge is.

Mr. McFarland: May I do so right now?

The Court: Yes.

Mr. Zeutzius: Yes, you may do so.

Mr. McFarland: Mr. White, have you ever had occasion to examine the books of any of those companies?

The Witness: No.

(Testimony of Ernest S. White.)

Mr. McFarland: You don't know the gross sales that they would show on their books for a year?

The Witness: No.

Mr. McFarland: You don't know the number of employees that any of them had during the course of 1942, for instance?

The Witness: No.

Mr. McFarland: You had occasion, I believe you testified on direct examination, to observe, let me say the area that the plant used in its physical building, is that correct? [129]

The Witness: Yes.

Mr. McFarland: Is that the basis of your comparison?

The Witness: That is right.

Mr. McFarland: But you know nothing of the financial records or the production performances of any of those companies?

The Witness: No, sir.

Mr. McFarland: And you have not examined the books and you don't know what the salaries paid various individuals in any of those companies were?

The Witness: That is right.

Mr. McFarland: I object to the question at this time.

Mr. Zeutzius: Well, may I suggest this: My understanding was, of course, that the witness in going about the trade, I understood he—probably I didn't ask all the questions that I should have, but I think that in going about the trade, I got the impression from the witness that he had gained very definite knowledge as to what various employees were paid.

(Testimony of Ernest S. White.)

Mr. McFarland: I object to this now, if the Court please. I believe the witness should testify. We have not sworn Mr. Zeutzius.

Mr. Zeutzius: Here is what I would like to do, [130] I would like to suggest in view of counsel's objection that I am satisfied to have the entire testimony of the witness go out.

Mr. McFarland: No, I will not agree to that, if the Court please.

The Court: I sustain the objection which is now being made to his testimony about the salary and wages paid these other concerns that he is about to testify to because I think his source of information would not be sufficient.

Mr. Zeutzius: Then let me ask this question—I have nothing further in view of your Honor's ruling.

By Mr. Zeutzius:

Q. Is the salary you received, do you know whether the salary you received at Alcoa, to which you testified, was that symbolic or typical of what was paid in the industry generally out there?

Mr. McFarland: I object.

Mr. Zeutzius: That is all I am asking him, if he knows.

Mr. McFarland: I object to the question.

The Court: I will overrule that objection.

The Witness: Well, I can state my own case. May I speak freely? At the time that I was production manager with Alcoa most of those foundries had growing pains, and they were paying a big amount for superintendents and so on [131] and

(Testimony of Ernest S. White.)

so forth, and I was offered by three companies at least a thousand dollars a month to take charge of production and scheduling. I turned the three of them down because I thought they were just war babies and they were not going to last. Then also I was working for Alcoa, a corporation, at that time. I also had no thought of leaving them to go into business for myself, and I figured we would have a job there for the rest of our lives. The only gripe was that they paid too low, but they pay you month in and month out for the rest of your lives, and as a matter of fact they have a retirement plan. That is why I stayed there although I was offered a good many times what I was getting at the Alcoa plant.

Mr. Zeutzius: No further questions.

The Court: Mr. McFarland?

Cross-Examination

By Mr. McFarland:

Q. How many years were you with Alcoa, Mr. White? A. About 11 years.

Q. During that time you were foundry man with them, what was your official title?

A. I started there shoveling sand in the foundry and I worked myself up to production manager of the sand and permanent molds plant.

Q. In other words, you gained a personal intimate [132] knowledge of the workings of the foundry?

A. I worked all the way through every department of the foundry, yes, many of them.

Q. And you had unique knowledge that everyone doesn't have, is that right? A. That is right.

Q. You stayed there for how long?

(Testimony of Ernest S. White.)

A. I worked for Alcoa for around 11 years.

Q. Then you went out and you went to a company called Valves Castings, Incorporated?

A. That is right.

Q. And you say you set yourselves up—by the way, was this a partnership of six men?

A. No, it was a corporation with six men in it.

Q. Did you each own one-sixth of the stock?

A. Yes, it was a closed corporation.

Q. How much stock did each one of you own?

A. We owned 40 shares of stock.

Q. How much did you six put in to get your start?

Q. Well, we started with \$10.00 a share, \$400.00.

Q. \$10.00 a share, and each put in 46 shares?

A. No, 40 shares.

Q. You set yourselves up on the books, I believe you said, at \$10,000.00? A. Yes. [133]

Q. Did you draw \$10,000.00? A. No.

Q. How much at any time did you draw a year?

A. We set that salary up, we had been going, we had been in operation for about maybe six or seven months, and we set that salary of \$10,000.00 a year, but I left there just about three or four months after that salary was set.

Q. When did you organize this corporation?

A. In the latter part of 1942.

Q. The latter part of 1942? A. Right.

Q. When did you leave the corporation?

A. The latter part of 1943.

Q. What rate of compensation did you draw or what did you take out of the company?

(Testimony of Ernest S. White.)

A. Well, we were not taking much out at that time. We were taking out a hundred dollars a week salary and expenses, at least I was, and the rest were withdrawing about a hundred dollars a week also, but most of the profits we made we put right back in the business for additional equipment, which we were sorely needing.

Q. About how much equipment? Up to the time you left Valves Castings, what was the amount of capital expenditure for equipment?

A. That would be hard to say. [134]

Q. You wouldn't know offhand?

A. No, I wouldn't know, but I could say roughly maybe 20 to 25 thousand dollars. Then, in addition—

Q. What was the business of Valve Castings? Did you make castings for airplanes and aircraft parts?

A. Yes, I think we worked 100 per cent on aircraft parts.

Q. When did the aircraft industry begin to expand greatly?

A. Well, it started to expand, I would say, three months before the war started, three or four months before the war started. You see, prior to that time Douglas was one of the biggest companies here in Los Angeles, as a matter of fact on the West Coast, outside of Boeing up there in Seattle. Northrup was still in operation, had a small, little plant, and North American was just beginning to start out, Lockheed was in operation too, but that was a small plant. As soon as the war started, everybody began to go leaps and bounds.

(Testimony of Ernest S. White.)

Q. This \$10,000.00 figure that you set up was just more or less of a mark to shoot at during the period you were with Valves, isn't that right?

A. Well, it was a mark to shoot at, yes, but we knew that we were going to make that also.

Q. You didn't know when, but you knew you were going [135] to make it?

A. Oh, yes, definitely.

Q. Then you got out of the foundry business; I believe you testified you got back in in February, 1945?

A. Yes.

Q. And you are now with the Aluminum Castings Company?

A. No, I am the owner of the E. S. White Company foundry.

Q. That is a sole proprietorship?

A. That is right.

Q. You are the sole owner of it?

A. That is right.

Mr. McFarland: I believe that is all.

Redirect Examination

By Mr. Zeutzius:

Q. I forgot to ask, Mr. White, have you ever worked on the commission basis in the sale of these aluminum products and in the sale of foundry products for aircraft?

A. Yes.

Mr. McFarland: I object. That is not proper redirect examination.

The Court: I will overrule the objection.

By Mr. Zeutzius:

Q. When were you so employed on that basis?

A. Well, when I went back to the Aluminum

(Testimony of Ernest S. White.)

Castings Company, I went back there the early part of last year and on a salary and commission basis.

Mr. McFarland: I ask that this testimony be stricken. It obviously relates to the year 1945, and on the same basis of your Honor's ruling on the year 1943 I ask that this be stricken.

The Court: I think so. I think that would be too long after the taxable year to be of any material value.

Mr. Zeutzius: Well, I would like to ask the witness whether the compensation—

Mr. McFarland: I don't believe the questions should be leading, either.

The Court: No, be careful, do not lead the witness.

By Mr. Zeutzius:

Q. Was there any change in compensation rates between 1942 and 1945, any substantial change?

Mr. McFarland: I object, if the Court please, to that question as too general, so general that it has no merit.

The Court: I sustain that objection. If this witness testified as to what commissions were paid in 1942 or thereabouts on sales, I think it might be of some value, if you want to ask him. [137]

By Mr. Zeutzius:

Q. Do you have any knowledge of what was paid to foundry salesmen engaged in a business similar to that of the petitioner at about 1942, where the salesmen operated on a commission basis?

A. Well—

Q. Do you have any such knowledge?

(Testimony of Ernest S. White.)

A. Well, I have no true knowledge, no, but I heard, I learned—

Q. At that time?

A. At that time, that—

Mr. McFarland: Well, in view of his first answer, if the Court please, I don't believe the last half of his answer is relevant or that he is capable of expressing an opinion on it.

Mr. Zeutzius: I submit that in the trade he would go in and around and hear and learn what is going on. It is hearsay in a sense.

The Court: Well, he may answer. If he had any general information about it, he may give the Court what information he had.

The Witness: Well, I was going to say that during that time when I began getting sick I tried to get a man to take my place on the outside, a man that knew the foundry business and also had the capabilities of being able to work [138] with these purchasing agents. I tried and tried and everyone that I got in there wanted a ten per cent commission plus \$100.00 a week guarantee.

Mr. McFarland: That was in 1942 when you began to take sick, isn't that right?

The Witness: Yes.

Mr. McFarland: I ask that that be stricken, if the Court please.

The Court: Well, I do not regard the testimony as of much importance, but I will not strike it.

Mr. Zeutzius: Is it stricken?

Mr. McFarland: No.

(Testimony of Ernest S. White.)

By Mr. Zeutzius:

Q. Ten per cent of what figure, do you mean?

A. Well, some of them wanted five or ten per cent of the gross, some of them wanted five or ten per cent of the net sales.

Q. In arriving at net sales, do you know what came off?

A. Well, that is all overhead and rejections and all expenses. As a matter of fact, five or ten percent of net sales would mean five or ten per cent of net profit.

Q. From the sales? A. From the sales.

Q. From the business. [139]

A. From sales.

Mr. Zeutzius: No further questions.

Recross-Examination

By Mr. McFarland:

Q. That is from five to ten per cent of the individual salesman's particular sales?

A. Yes.

Q. In other words, if you were the individual salesman, if your net sales for the year were \$30,000.00, ten per cent would be \$3,000.00, is that right?

A. That is right.

Q. Would that be what he would want?

A. That is right.

Q. And this information just now relates to 1943, is that right?

A. Well, no, because you see I have been in this business for a good many years prior to that. This includes 1941, 1942 and 1943, up until last year as a matter of fact.

Q. And it is the same all through?

(Testimony of Ernest S. White.)

A. That is right.

Mr. McFarland: I believe that is all.

Redirect Examination

By Mr. Zeutzius:

Q. One question, as the result of counsel's question. Do you know what would be normal for the total sales of the [140] average salesman? Would it be as high as \$30,000.00?

Mr. McFarland: I object, if the Court please.

The Court: Yes, I sustain that objection.

By Mr. Zeutzius:

Q. Would \$30,000.00 represent a fair estimate of total sales during a year for a salesman?

Mr. McFarland: That is again objected to.

The Court: I hadn't understood the last question that you put as being anything more than the other question.

Mr. Zeutzius: No further questions. That is all.

Mr. McFarland: That is all.

(Witness excused.)

Mr. Zeutzius: Now, there is one further witness in a similar situation who I think will be much shorter, if I may call him. Mr. Temple. Mr. Temple, will you take the stand?

Mr. McFarland: If the Court please, I make the same objection to this witness' testimony. I believe he was likewise in the court room for some time. The same objection that I made to the prior witness' testimony I now make to this witness' testimony.

The Court: What do you expect to prove by this witness?

Mr. Zeutzius: I expect to show what he made as a salesman, I think it is, about the year 1942 or thereabouts. [141]

The Court: Well, I will receive the testimony. Whereupon,

HUBERT A. TEMPLE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Huee Temple?

A. Hubert A. Temple.

Q. What is your age, Mr. Temple?

A. 24.

Q. What is your occupation at the present time?

A. Salesman.

Q. Of what?

A. Foundry products, castings, etcetera.

Q. Aluminum castings?

A. Aluminum and magnesium.

Q. Those sales are made chiefly to what type of customers?

A. Well, they are any manufacturing facilities that would use aluminum.

Q. What was your occupation in 1941 and 1942?

A. In 1941 I was a buyer at North American. In 1942 I was a salesman for a magnesium foundry.

Q. When you say North American you mean the North American Aircraft Company here near Los Angles? A. Yes, sir.

(Testimony of Hubert A. Temple.)

Q. You were a buyer, did you say?

A. That is right. I was buying castings and patterns and merchandise of every nature.

Q. During that time did you do business with Aluminum Alloys and Alcoa and the Socal and the major foundries? A. Yes.

Q. During 1942 did you do business on behalf of North American with the petitioner, Walts, Inc., known as Dural Alloys? A. That is right.

Q. Did you have occasion to meet Mr. Cunningham at that time?

A. I knew Mr. Cunningham and most of the men who worked for him, I would say all of them.

Q. Had you ever been in their plant?

A. Yes, sir, that was part of my job, to inspect the facilities to see that they were capable of turning out aircraft parts, especially under the Army inspection system.

Q. What was the situation with respect to competition for the furnishing of parts by the various foundries to your company?

A. In the aluminum business there was a great deal of [143] competition. We had salesmen calling on us every day trying to sell us aluminum castings.

Q. Did you give all of them orders?

A. It was impossible to give all of them orders, because aircraft castings are a special industry, where you have to be able to make a casting to withstand the stresses of an airplane in flight.

Q. Did you find orders were actually placed with Walts, Inc., or Dural Alloys? A. Yes, sir.

(Testimony of Hubert A. Temple.)

Q. Did you have occasion to determine the quality of the aluminum products that were furnished according to those orders?

A. No, I inspected the facilities, their machines, heat-treatment machines, everything that they had in the foundry. I didn't have to inspect the product. That goes to our inspection department where they conduct tests and learn their physical and chemical requirements.

Q. So you never inspected the products?

A. No, sir, only the equipment. That was done by the inspection department.

Q. Were those products satisfactory as far as Walts, Inc., was concerned? A. Yes, sir.

Q. Do you know anything concerning Mr. Cunningham's [144] abilities in connection with the production of those parts?

Mr. McFarland: I object to that. The witness might tell what he knows about Mr. Cunningham's activities in the production. I think it is clearly inadmissible and incompetent now.

By Mr. Zeutzius:

Q. Do you know anything concerning Mr. Cunningham's activities in connection with the production of these parts which you purchased for North American?

A. Well, we had all of our dealings with Mr. Cunningham. He was the one that we placed the orders with and it was his responsibility to deliver them to North American, and I understood that they were delivering castings according to their promise.

(Testimony of Hubert A. Temple.)

Q. Who was the salesman?

A. All of our contacts were with Mr. Cunningham, if that is what you are getting at, in the respect of giving him orders, and when we wanted any information we called him, if we wanted information on deliveries we called him, and if we wanted information about a casting, whether a casting should be redesigned, we would call Mr. Cunningham and talk over the alloys.

Q. You changed your position from a buyer into a salesman?

A. Salesman, that is right. [145]

Q. When did that occur?

A. In June of 1942.

Q. For whom did you act as a salesman thereafter?

A. The Los Angeles Magnesium Casting Company.

Q. Do you know whether it is comparable in size to the petitioner? A. Yes.

Q. You think they are about the same size?

A. That is right, yes.

Q. What salary did you receive from Los Angeles Magnesium Casting Company, in June, 1942, or shortly thereafter?

A. My contract was to get three per cent of the gross sales.

Q. Your gross sales?

A. That is right, which were all of the sales.

Q. You were the only salesman?

A. That is right.

(Testimony of Hubert A. Temple.)

Mr. Zeutzius: Here is a man knows very well what they were paid.

Mr. McFarland: That is probably on a hearsay foundation as most, and he has testified he doesn't know how much salaries were.

Mr. Zeutzius: Well, counsel, I submit that—well, never mind.

By Mr. Zeutzius:

Q. What basis do you have for your statement that they were considerably higher than yours?

A. Well, I have never seen a salesman yet who made more than the owners of the business. It is just a definite feeling in knowing certain things, they don't usually pay somebody three times their own salary, not when they have the risk of supporting the business. That is only common business sense.

Mr. Zeutzius: No further questions of this witness.

Cross-Examination

By Mr. McFarland:

Q. You say you have never seen a salesman yet who made more than the owner of a business?

A. No, sir. [149]

Q. What investigation into that particular question have you made independently, on your own?

A. Being a buyer at North American, I talked to a great deal of them. I like people and find out as much as I can about people, and it just has been my observation that a salesman is not paid

(Testimony of Hubert A. Temple.)

more than the president or directors of a going concern.

Q. Well, now, the director of a going concern, what would his compensation be?

A. It depends on the business.

Q. What would it be based upon?

A. His ability, shouldn't it?

Q. I am asking you the questions. I am trying to find out.

A. His ability, all right.

Q. When you were a buyer at North American you had talked with various salesmen from companies that were furnishing materials to North American, is that right?

A. Right.

Q. From those talks with them, did you determine that the owners were being paid in each instance more than the salesmen, is that the source of your information?

A. May I counter that with something?

Q. That is an easy question to answer yes or no, I believe. [150]

A. Well, I think you could answer it yes, then.

Q. Where did you go to school?

A. Manual Arts High School.

Q. In Los Angeles?

A. Right.

Q. From there where did you go?

A. I took a couple of courses at U. C. L. A. at nights.

Q. Specializing in any particular field?

A. Economics of the aviation industry and production management.

Q. You specialized in the economics of the aviation industry?

(Testimony of Hubert A. Temple.)

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Q. Specializing in any particular field?

A. Economics of the aviation industry and production management.

Q. You specialized in the economics of the aviation industry?

(Testimony of Hubert A. Temple.)

A. That was the name of the course.

Q. What did you study in that connection?

A. Mainly the cost-plus system in aircraft, the post-war anticipations of the aircraft industry, the suppliers who supplied parts to the aviation industry. It was a rounded course of economics of a specific business.

Q. And that qualified you very well, did it not, for your job at North American?

A. You learn a job through practical experience, I have found.

Q. Did you apply any of the knowledge that you had gained during the course of your study at U.C.L.A. to the [151] job that you had in 1941?

A. Nothing more than the average student would know about buying castings.

Q. You didn't have any particular knowledge of the problems in the department in which you went to work, is that right, when you walked into the place? A. Absolutely right.

Q. Have you ever seen a balance sheet of Walts, Incorporated? A. No, sir.

Q. Have you ever seen the sales journal?

A. No, sir.

Q. Never seen any of the books of account, have you?

A. In 1941 North American, 1941 and 1942, North American required a statement from all suppliers, but at this time I do not recall the figures. I just know we got all that information.

Q. When did you go to work for the Los Angeles Company? A. In June of 1942.

(Testimony of Hubert A. Temple.)

Q. You went to work for them as a salesman, but you also were production manager or you ran the production, I believe. A. That is right.

Q. With the help of a small boy? [152]

A. Well, I had a boy. He was 19, out of school.

Q. How many men work for this magnesium company or did work for then in 1942?

A. At the end of 1942, as I remember, about 80.

Q. About 80. Do you know what the main portion of their business consisted of?

A. Aircraft castings.

Mr. McFarland: I believe that is all.

Mr. Zeutzius: One question, if I may, by way of direct. May I ask counsel a question? I don't know, your Honor, if I asked this witness as to whether he knew back in 1942 what was being paid other salesmen doing similar work to that of the witness.

The Court: I don't think you asked him that. You asked him what he was paid. I don't think you asked him if he knew what other salesmen were paid.

Mr. Zeutzius: I would like to ask him that question, then.

Redirect Examination

By Mr. Zeutzius:

Q. Do you know what other salesmen were paid at about the same time you went to the Los Angeles Magnesium?

A. In the aluminum industry they ran between

(Testimony of Hubert A. Temple.)

five and ten percent and magnesium it ran between two and three per cent. [153]

Q. Of what? A. Gross sales.

Mr. Zeutzius: No further questions.

Recross-Examination

By Mr. McFarland:

Q. About three per cent of the gross sales?

A. That is right.

Q. You were in magnesium?

A. That is right, sir. It is a higher-priced article and naturally the salesmen are not paid as much.

Q. I suppose it is the same in that business as in any other, you start at the bottom and work up, is that right? Is that why you started in at three per cent rather than five per cent?

A. No, I just saw possibilities there.

Q. That would more than compensate you for the lower percentage?

A. That is right, sir.

Q. The particular situation of the company, then, would have some bearing upon the percentage which you would expect the salesman to go to work for the company, wouldn't it?

A. Growth possibilities, yes.

Q. And your possibilities of growing along with the company and some day maybe run the company? [154]

A. That is right.

Q. Through stock ownership? A. What?

Q. Through stock ownership of the company?

A. Well, ordinarily, if the stock is not listed on

(Testimony of Hubert A. Temple.)

the Exchange, it is very hard to purchase. I never gave it much thought.

Mr. McFarland: That is all.

Mr. Zeutzius: No further questions.

The Court: That is all.

(Witness excused.)

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: I will put Mr. Cunningham back on now.

Whereupon,

WALTER JAMES CUNNINGHAM

recalled as a witness for and on behalf of the petitioner, having been previously duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Mr. Cunningham, will you resume the stand. As a result, counsel, of the resolutions that you offered, I have two questions to ask, one with reference to the January 5 resolution and one with reference to the August 28. On January 5, 1942, when the directors' meeting occurred at [155] which the salaries were fixed at \$24,000.00 per year for you and Mr. Morse, what was the business outlook for Walts, Inc., on January 5, 1942?

A. Well, very promising, and as a matter of fact, had actual orders on the books, I think, at that time, totalling 35 or 40 thousand dollars plus. That is orders, I mean, not promises, but actual orders on the books.

(Testimony of W. J. Cunningham.)

Q. Were there any commitments?

A. And commitments, yes, and a considerable backlog that, of course, did not develop until later on in the year.

Q. What do you mean by "backlog"?

A. Well, a backlog of orders, that is, while the patterns had not been made, and the patterns had to be made and they had to be proven and the price had to be proven and made before actually delivering any castings on the orders. In other words, the company had anywhere from four to five or six months' work just to prepare those castings.

Q. On August 28, 1942, on the occasion of the meeting when the salaries were raised to \$36,000.00, what was the business outlook of Walts, Inc.?

A. I believe at that time we had a backlog of around a half a million dollars of unfilled orders, probably, and had actual orders placed with the company that we had on our books.

Mr. Zeutzius: No further questions. [156]

Cross-Examination

By Mr. McFarland:

Q. It looked like Walts, Inc., would have a good business year in both of those years?

A. That is correct.

Q. It was getting to look as if you couldn't lose, was it not? A. That is right.

Q. So you decided to pay yourselves more salary, I believe that is what you spoke about, something about "we agreed under the circumstances," did you say that? A. That is true.

Q. I was just wondering, when you were con-

(Testimony of W. J. Cunningham.)

sidering as a director the salaries that you were going to pay yourself and Mr. Morse on January 5, you were considering as a director that you were going to be reimbursed to a certain extent?

A. No.

Q. That never entered your mind?

A. No.

Q. You just contributed that?

A. That is correct. That is right. Frankly, I was the one to approve of any contributions, don't you believe so?

Q. Pardon? [157]

A. I was the one to approve of any contributions going in the business.

Q. You were not a stockholder?

A. No, I was not a stockholder.

Q. You were on a salary?

A. I was on a salary, yes.

Q. I believe you testified that there was also no element of or that you did not consider part of the salary in the nature of a dividend or a distribution of profits?

A. That is correct. I was not a stockholder.

Q. I believe you had a gross profit for that year of about \$100,000.00, isn't that right?

A. Approximately so, I would say.

Q. And you paid out in salaries for that \$56,000.00? A. I believe that is the figure, yes.

Q. You had other expenses of about 19,000?

A. Well, the balance sheet is there. It can be proven.

(Testimony of W. J. Cunningham.)

Q. I think that checks with the balance sheet.

A. Well, that is approximately so.

Mr. McFarland: I believe that is all.

Mr. Zeutzius: No further questions. Now, is Mr. Stevens here? Let me call Mrs. Cunningham, please.

(Witness excused.) [158]

Whereupon,

CATHERINE S. CUNNINGHAM,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Mrs. Catherine Z. Cunningham?
A. Catherine S. Cunningham.

Q. You are the wife of Walter J. Cunningham?

A. I am.

Q. President of Walts, Incorporated?

A. I am.

Q. During 1942, Mrs. Cunningham, you were a director and vice-president of Walts, Inc.?

A. I was not a vice-president in 1942.

Mr. McFarland: This is all in the stipulation.

The Witness: Oh, in 1942, yes. I am sorry. I was. That is right.

By Mr. Zeutzius:

Q. When did you acquire your stock in the corporation—in fact, I think the stipulation shows.

Mr. McFarland: We have got it set out very fully, if the court please. [159]

(Testimony of Catherine S. Cunningham.)

By Mr. Zeutzius:

Q. And the money that was used, the \$500.00 used to purchase the stock, where did you get the money? A. I borrowed it from my father.

Q. Now, in 1942, on January 5, do you recall a directors' meeting at which the matter of salaries of the two main officers were discussed?

A. I do.

Q. Do you also recall another meeting in August, on August 28, at which the salaries of the two active officers were fixed? A. I do.

Q. Now, about August 14, do you recall a meeting at which the directors were authorized to be paid a \$25.00 fee for each meeting attended thereafter?

A. I do. I am not sure of the dates, but I know that it was authorized.

Q. Were you present at all of the meetings for which you received \$25.00? A. I was.

Q. What did you do? Did you render any services? What did you do for the \$25.00 that you received?

A. Well, I discussed various things. The corporation was closely held, and Mr. Cunningham and I have always discussed business ever since we have been married, and Mr. [160] and Mrs. Morse felt the same way, and were present at all times, so we decided to have these directors' meetings once a month, at which we discussed things pro and con and tried to make suggestions, and we discussed various matters that possibly changed the course of the business.

(Testimony of Catherine S. Cunningham.)

Q. Were the other two directors, Mr. and Mrs. Morse, also present at each of those meetings?

A. Yes, they were.

Q. Did they participate in the meetings?

A. In the discussions, yes, very much so.

Q. In your opinion, in the fixing of the \$25.00 fee for attendance at each of the directors' meetings, was that a fair and reasonable compensation?

A. We thought it was at the time.

Q. Do you still think so? A. I do.

Q. With respect to the salaries fixed for the two officers on January 5, 1942, take that one as a separate question, was it your opinion as a director at that meeting that the salary fixed for each of the two directors was fair and reasonable?

A. It was.

Q. Was it your opinion that it was fair and reasonable as it was fixed on August 28, 1942, when it was raised to the rate of \$36,000.00 a year? [161]

A. I thought that increased production and increased responsibilities warranted it, yes.

Mr. Zeutzius: You may cross-examine.

Cross-Examination

By Mr. McFarland:

Q. During 1941 and 1942 were you an officer of the company?

A. I was vice-president and director in 1942.

Q. And now, in that connection, in your duties as vice-president, what did you do?

A. Well, my duties were very limited. I was not very active at the time, but I was later on in the business. It was more or less secretarial work.

(Testimony of Catherine S. Cunningham.)

Q. Later on, what do you mean by "later on"?

A. Those are years that we do not discuss right now.

Q. You don't discuss right now 1941 and 1942?

A. I thought you meant in 1943. In 1941 and 1942 I was at the plant every day in the office.

Q. What did you do at the plant?

A. I did considerable typing and I helped the payroll clerk and I helped on the office work under Mr. Morse.

Q. How does the company keep its books, do you know?

A. Mr. Morse was in charge of the books at that time, and of course the auditors.

Q. Do you know how the books are kept? [162]

A. No, I don't, not at that time.

Q. You don't know whether they are kept on a cash basis or on the accrual basis?

A. I was not interested in that. Mr. Morse was in charge of that.

Q. Do you have any knowledge of the situation?

A. No, I haven't.

Q. What else did you do as vice-president?

A. That is all.

Q. You were there every day? A. I was.

Q. How long did you spend at the plant every day?

A. About five or six or eight hours, sometimes ten, if Mr. Cunningham was working, might stay about—many times we didn't leave there until 9 o'clock at night.

(Testimony of Catherine S. Cunningham.)

Q. You were never paid any compensation for the work? A. I was not, no.

Q. Did you ever ask for any compensation?

A. No, I didn't.

Q. You felt that the compensation would be paid your husband and he recompense you for the work you did?

A. Well, not necessarily. I was simply trying to help out.

Mr. Zeutzius: I didn't hear the answer.

The Witness: I was simply trying to help out.

By Mr. McFarland:

Q. You were interested in seeing the officials make a success, weren't you?

A. Naturally, it was my husband.

Q. How did you as a director determine the 240,000 figure that you adopted in January of 1942?

A. Well, I don't know as I recall what our conversations were about that time. That was remuneration in the first place for 1941. Mr. Cunningham had drawn nothing and we had lived on borrowed money, one reason, one thing was because I think it would have been impossible to get the money for the success of the business. It would have been entirely lost if my relatives had not always known of his ability in the past.

Q. You didn't quite answer my question. I want to know how you determined \$24,000.00 was to be the figure instead of 20,000 or 25,000.

A. Because he had been in the habit of earning that money in the past. I had always had an excellent income of 20 to 25 thousand a year.

(Testimony of Catherine S. Cunningham.)

Q. Did Mr. Cunningham, to your knowledge, invest any of his money in the business at any time?

A. In which business do you mean?

Q. This business. A. No, he didn't. [164]

Q. In this Walts, Incorporated?

A. No, he didn't.

Q. What did you do before you married Mr. Cunningham? A. I was in school.

Q. You have a family, have you not?

A. I have.

Q. And you keep a house? A. I do.

Q. You did during 1941 and 1942?

A. I did, but my children are grown and I was not in the home as much.

Q. How old were they then?

A. Well, I have a daughter 26 and one 24 and a son 18 right now.

Q. Where did you hold these directors' meetings? A. At the office.

Q. What time of the day would they be?

A. Around six o'clock as a rule, sometimes 5:30.

Q. You say you discussed the problems that arose in the business at that time?

A. Yes, we did.

Q. Well, do you recollect discussing the company's purchase of a heat-treating furnace?

A. I certainly do. [165]

Q. How much did they pay for it?

A. I can't remember what the Lindbergs—we had a full discussion of the various furnaces and decided they were the best, even though they were the highest.

(Testimony of Catherine S. Cunningham.)

Q. Did you discuss that? A. Yes.

Q. You did?

A. At that time it was very hard to get heat-treating furnaces, but it so happened that my brother-in-law, who was with Reynolds Metals, through his connections with Reynolds Metals, was able to get a Lindberg furnace for us. Otherwise they would not promise delivery.

Q. Do you know why the Lindberg furnace is best?

A. I don't know, but we have a metallurgist and his opinion was it the was the one for us.

Q. Did you talk to him?

A. I did, because I went East for that purpose.

Q. You have never drawn any salaries or any compensation for other than director's fees?

A. Up to 1942, no.

Mr. Zeutzus: You are referring to the taxable period?

Mr. McFarland: That is right.

The Witness: No.

Mr. McFarland: I think that is all. [166]

Mr. Zeutzus: No further questions. Thank you, Mrs. Cunningham. And now I believe Mrs. Cunningham can stay in the court room.

(Witness excused.)

Mr. Zeutzus: Is Mr. Stevens here? Your Honor, we have subpoenaed Mr. Elmer D. Morse, who is no longer with the company and who at best would undoubtedly be an unwilling witness. Your Honor signed the subpoena yesterday and I tried person-

ally to get him here. I talked with him on the phone and Mr. Cunningham has sought him earlier. If you deem necessary, I will be very happy to have the process server take the stand at a later time. He was here this morning. The only purpose would be to have him take the stand to show that we tried to get the man in and that is the reason why he has not testified in this case.

The Court: Well, I am willing to accept your statement that you have endeavored to get this witness by means of a subpoena to testify here, and just what effect that might have on this case I don't know, but to say the least of it, if possible failure to testify you feel should be an unfavorable factor here, it would be removed by your statement that you endeavored to get him.

Mr. Zeutzius: I have, your Honor, and this gentleman who was here this morning is the man who tried.

The Court: Yes. Well, I will assume for the [167] purposes of this hearing that you have endeavored to get the attendance of Mr. Morse as a witness.

Mr. Zeutzius: We have. I think that concludes the petitioner's case in chief.

Mr. McFarland: Respondent rests.

Mr. Zeutzius: And we therefore rest.

The Court: Very well. That concludes the hearing in the case. This is a case where it is largely one of fact, except a question of law which the petitioner says he is going to urge in the case. Now, I will call for a filing of an opening brief for the petitioner, then a reply brief by respondent and then

an answering brief by the petitioner. What time would you like to have within which to file your opening brief?

Mr. Zeutzius: Well, let's see. This is the last of June. I am going on my vacation in August, so may I ask when in the normal course we would get the transcript—45 days, I don't go until August, so I will try to get my brief in. Suppose your Honor makes it 45 days and if I get it in sooner—is that too much time?

The Court: Well, no. August 5th would be somewhat a little more, I believe, than 45 days.

Mr. Zeutzius: As I understand, we mail it to Washington?

The Court: To the clerk of the Tax Court, yes.

Mr. Zeutzius: And serve counsel here first?

The Court: Yes, you serve him with a copy.

Mr. Zeutzius: We can serve counsel here about the first of August, get it to the Tax Court in the ordinary course of mail, I suppose, in a couple of days. Make it any date that you wish to make it.

The Court: Well, I will fix August 5th, and then the respondent may have until September 5th in which to file his reply brief, and then the petitioner may have until October 5th in which to file his final answering brief.

Mr. Zeutzius: Thank you, your Honor.

(Whereupon, at 3:15 o'clock p. m., June 18, 1946, the hearing in the above-entitled matter was closed.)

[Endorsed]: T.C.U.S. Filed July 8, 1946. [169]

[Endorsed]: No. 12143. United States Court of Appeals for the Ninth Circuit. Walts, Inc., petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Petition to Review a Decision of the Tax Court of the United States.

Filed January 3, 1949.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

Docket No. 6974

WALTS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AFFIDAVIT IN SUPPORT OF APPLICATION
FOR EXTENSION OF TIME TO FILE
RECORD ON REVIEW

County of Los Angeles,
State of California—ss.

Geo. H. Zeutzius, being first duly sworn, deposes and says:

That he is one of the attorneys of record in the above entitled cause, and that heretofore a number of extensions of time have been granted by this Court for the filing of the record on review from

the decision of the Tax Court of the United States; that said extensions of time were granted to permit compromise proceedings having for their object the settlement not only of the above entitled cause but other claimed income tax liabilities for subsequent years; that the last of said orders was made on December 14, 1948 and extended petitioner's time to file the record on review in the above entitled Court from December 15, 1948 to January 1, 1949.

That by reason of the short extension of time thus granted counsel for petitioner immediately instituted proceedings to have the record on review transmitted by the Clerk of the Tax Court of the United States to the Clerk of the above entitled Court; that on Monday morning, December 27, 1948, counsel for petitioner received the following telegram from the Clerk of the Tax Court:

“Copy designation *Walts, Inc.* arrived December twenty fourth original may be filed to-day considerable photostating required utterly impossible to get record to Ninth Circuit January first suggest you get twenty day extension and wire us that fact.

VICTOR S. MERSCH, Clerk.

That, as appears from said telegram, the Clerk of the Tax Court requires to and including January 21, 1949 in order to transmit the record on review to the clerk of this Court.

Wherefore, affiant prays that petitioner's time

within which to file the certified record on review with the clerk of this Court be extended to January 21, 1949.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 27th day of December, 1948.

/s/ A. P. G. STEFFES,
Notary Public in and for the County of Los Angeles, State of California.

Ordered time extended to January 4, 1949.

/s/ WILLIAM DENMAN,

[Endorsed]: Filed December 29, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS AND DESIGNATION OF RECORD

Pursuant to Rule 19(6) of the Rules of the United States Court of Appeals for the Ninth Circuit, petitioner files this concise statement of the points on which it intends to rely.

I.

Petitioner, upon the hearing of its petition for review herein, intends to rely upon all of the points specified in its "Assignment of Errors," Nos. 1 to 13, both inclusive, contained in its petition for review by this Court, filed with the Clerk of the Tax Court of the United States on July 7, 1947, which points are incorporated herein by reference.

II.

Since, by P. L. 773, 80th Cong., amending Sec. 1141, I.R.C., effective September 1, 1948, United States Courts of Appeals have been given jurisdiction to review decisions of the Tax Court in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury, petitioner also intends to rely upon the following additional points:

(a) The Tax Court erred in entering decision for respondent.

(b) The Tax Court erred in not entering decision for petitioner.

(c) The Tax Court erred in failing to find or conclude that there were no deficiencies in declared value excess profits tax and excess profits tax due from petitioner for the calendar year 1942.

(d) The Tax Court's finding and conclusion that "a reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner * * * during the year 1942 was \$10,000 per annum for each" is erroneous and without support by any substantial evidence.

(e) The Tax Court's special findings of fact do not support its ultimate findings of fact and conclusions against petitioner.

(f) The Tax Court's primary or evidentiary findings of fact are incomplete and clearly erroneous in all material respects, in the light of the uncontradicted evidence of petitioner and the fact that Judge Harlan, who decided the case, was not the trial judge and, therefore, had no opportunity what-

soever to judge the credibility of the witnesses.

(g) The Tax Court erred in failing to find and conclude that \$28,000 was a reasonable allowance for salary for services rendered by Walter J. Cunningham to petitioner for the year 1942, and in failing to make a similar finding and conclusion with respect to Elmer D. Morse.

III.

DESIGNATION OF PARTS OF RECORD TO BE PRINTED

Petitioner respectfully submits that the entire record and all of the proceedings, evidence and exhibits in the case, as certified to you, and as set forth in the stipulated designation of record filed in the Tax Court on December 27, 1948, will be necessary for the consideration of the points upon which petitioner intends to rely. Accordingly, petitioner requests you to have printed the entire record on review, including this Statement and Designation and all orders entered by this Court herein since December 27, 1948, except that there should be omitted the opening statements of counsel commencing with the 18th line on page 2 of the typewritten transcript of the hearing, filed July 8, 1946, and continuing to and including line 1 at the top of page 15 thereof; and there also should be omitted from the printed record, but only in the event this Court should grant petitioner's motion that the same shall be considered by the Court in their original form as though set out in the printed record, the following exhibits and papers: Exhibit 1-A of Stipula-

tion of Facts, which exhibit consists of three letters numbering 12 pages, already described as to their contents in paragraph numbered 6 of said Stipulation; Petitioner's Exhibits 10 and 11 consisting of its 1940 income tax return, and petitioner's corporate minutes of August 14, 1942 authorizing the directors' fees which were allowed by the Tax Court; Respondent's Exhibits J, K, L, M and N, consisting of petitioner's 1941 and 1942 tax returns and petitioner's corporate minutes of March 31, 1941, referred to in paragraph numbered 7 of the Stipulation of Facts; its minutes of January 5, 1942, referred to in paragraph 11 of the Stipulation of Facts, and its minutes of August 28, 1942, already set forth almost in their entirety in paragraph numbered 15 of the Stipulation of Facts; also Respondent's Computation for Entry of Decision, together with its annexed computation, filed March 10, 1947.

Dated, January 12, 1949.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

(Affidavit of Service by Mail.)

[Endorsed]: Filed January 15, 1949. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

MOTION FOR ORDER FOR CONSIDERATION
OF EXHIBITS IN ORIGINAL FORM

Petitioner, by its attorneys, moves the Court to enter an order that the following exhibits and papers forming part of the entire record and proceedings on review herein, certified to this Court by the Clerk of the Tax Court, shall be omitted from the printed record on review herein, and that said omitted exhibits and papers shall be considered by this Court in connection with this review in their original form as though set out in said printed record on review:

1. Exhibit 1-A, consisting of three letters described in paragraph 6 of the Stipulation of Facts;

2. Petitioner's Exhibits 10 and 11, consisting of its 1940 income tax return and petitioner's corporate minutes of August 14, 1942 authorizing the directors' fees which were allowed by the Tax Court;

3. Respondent's Exhibits J, K, L, M and N, consisting of petitioner's 1941 and 1942 tax returns and petitioner's corporate minutes of March 31, 1941, referred to in paragraph numbered 7 of the Stipulation of Facts; its minutes of January 5, 1942, referred to in paragraph 11 of the Stipulation of Facts, and its minutes of August 28, 1942, already set forth almost in their entirety in paragraph numbered 15 of the Stipulation of Facts; and

4. Respondent's Computation for Entry of De-

cision, together with its annexed computation, filed March 10, 1947.

For reasons in support of this motion, petitioner states:

The printed record will be large and costly to petitioner and the substance of the particular exhibits described above is already materially set forth in parts of the record that will be printed. The elimination of these exhibits ought to result in the elimination of at least 50 pages from the printed transcript. Their omission will not inconvenience the Court or the parties and it is, therefore, respectfully prayed that this motion be granted.

Dated, January 12, 1949.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: Filed February 1, 1949. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF ORIGINAL EXHIBITS

The above-designated petitioner on review having duly filed its motion for consideration, in their original form, of the exhibits heretofore transmitted to this Court by the Clerk of the Tax Court, and good cause therefor appearing:

It is Hereby Ordered that Exhibit 1-A of the Stipulation of Facts; Petitioner's Exhibits 10 and 11; Respondent's Exhibits J, K, L, M and N, and Respondent's Computation for Entry of Decision, together with its annexed computation, all of which exhibits were introduced in evidence before the Tax Court of the United States in the proceeding from which the present review has been taken, and heretofore transmitted to this Court in their original form and now in the files of the above-entitled proceeding on review in this Court shall be omitted from the printed record on review herein, and that said omitted exhibits, and Respondent's Computation for Entry of Decision, shall be considered by this Court in connection with this review in their original form as though set out in said printed record on review.

Dated, January 14, 1949.

/s/ WILLIAM DENMAN,
Judge, U. S. Court of Appeals.

/s/ WILLIAM HEALY,
Judge, U. S. Court of Appeals.

/s/ HOMER T. BONE,
Judge, U. S. Court of Appeals.

[Endorsed]: Filed February 1, 1949. Paul P. O'Brien, Clerk.

No. 12143

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

GEORGE H. ZEUTZIUS,

A. P. G. STEFFES,

518 Security Building, Los Angeles 13,

Attorneys for Petitioner.

FILED

MAY 18 1949

PAUL P. O'BRIEN

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No. 12143

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

Opinion Below.

The memorandum findings of fact and opinion of the Tax Court [R. 47-61] are not reported.

Jurisdiction.

The petition for review [R. 69-77] involves the determination of deficiencies in federal corporation declared value excess-profits tax, and excess profits tax, for the taxable calendar year of 1942. [R. 5, 20, 47.] On October 27, 1944, respondent mailed to petitioner the required statutory notice of deficiency. [R. 11-20.] Within ninety days thereafter, on January 23, 1945, petitioner filed a petition with the Tax Court of the United States for re-determination of those deficiencies, pursuant to the provisions of Section 272 of the Internal Revenue Code. [R. 1, 5-21.] An amendment to petition was filed on June 18, 1946. [R. 21-23.] Respondent filed answers to the petition and amendment to petition. [R. 20-21, 23-24.] The

proceeding was tried on June 18, 1946, at Los Angeles before Judge Eugene Black, who was designated, pursuant to Section 1103, Internal Revenue Code, as a one-judge Division to hear and determine this case. [R. 2, 61-62.] A partial stipulation of facts was filed [R. 24-45], and both oral and documentary evidence were introduced by petitioner. No witnesses were produced by respondent. On January 17, 1947, memorandum findings of fact and opinion, by Judge Byron B. Harlan, were promulgated. [R. 3, 47-61.] Petitioner's motion for rehearing *de novo*, filed February 17, 1947, was denied by Judge Byron B. Harlan on February 17, 1947. [R. 61-65.] On April 10, 1947, the Tax Court, by Judge Harlan, entered its final order and decision redetermining deficiencies for 1942 of \$955.20 in declared value excess-profits tax and \$27,942.80 in excess profits tax. [R. 66.] On April 18, 1947, petitioner filed a motion to correct the decision in respect of the 10 per cent post-war credit to which petitioner concededly [R. 67] was entitled, under Sections 780 and 781(c) of the Internal Revenue Code, in connection with the determined deficiency. [R. 67-68.] This motion was denied on April 21, 1947. [R. 68.]

The case is brought to this Court by taxpayer's petition for review filed July 7, 1947 [R. 69-77], pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code. On August 12, 1947 [R. 80], December 12, 1947 [R. 81-82], January 29 [R. 82], April 12 [R. 83], July 8 [R. 83-84], October 13 [R. 84], December 14 [R. 85] and December 29, 1948 [R. 223], this Court timely entered orders extending the time for filing the certified record on review. This appeal and the transcript of record were duly filed and docketed in this Court on January 3, 1949. [R. 221.]

Statement of the Case.

1. This proceeding is to review a decision of the Tax Court, which redetermined federal corporate tax deficiencies against petitioner for 1942 in the amounts of \$955.20 declared value excess-profits tax and \$27,942.80 excess profits tax. This case was assigned for hearing and decision to Judge Eugene Black, sitting as a one-judge Division (No. 15) of the Tax Court. Judge Black heard the testimony of four witnesses for petitioner and received documentary evidence in the trial of the case at Los Angeles. Nearly six months thereafter, without notice to petitioner and without any order entered or docketed in the case with respect thereto, the proceeding was decided and determined by Judge Byron B. Harlan (Division No. 11), a then recently appointed judge who was not present at the time of trial and who did not see or hear the four witnesses who testified for petitioner. Judge Black at all times continued to function and serve as a judge of the Tax Court. [R. 64.] No reason was assigned for the sudden entry of Judge Harlan into the case. Following notice of filing by Judge Harlan of memorandum findings of fact and opinion, petitioner's motion for rehearing *de novo* [R. 61-65] was promptly filed, and denied by Judge Harlan. [R. 65.] Petitioner's motion, among other things, challenged Judge Harlan's authority to act.

Therefore, the first question presented is whether Judge Harlan's memorandum findings of fact and opinion should be vacated and the decision based thereon reversed and the case remanded for a new trial, in view of the deprivation of petitioner not only of its right to a "public hearing," as provided by Section 1116, Internal Revenue Code, but also of its concomitant right to a decision or determination of the issues and to findings of fact by the trial judge,

as provided by Sections 1117(b) and 1118(a), Internal Revenue Code, and required by the “due process” clause.

2. The next and related question is: Did the Tax Court err in denying petitioner’s motion for rehearing *de novo* in view of the facts stated above and the grounds set forth in the motion?

3. Under Rule 35(b) of the Tax Court, a petitioner, in its opening brief in that court, is required to set forth in numbered fashion complete statements of the facts “based upon the evidence,” giving references to the transcript pages and exhibits in support of each statement. This the petitioner did in 24 numbered statements in its opening brief. Rule 35(b) also provides that “If the other party disagrees with any or all of the statements of fact,” he “shall give the same numbers to his statements of fact as appear in his opponent’s brief” and “his statement of fact shall be set forth in accordance with the requirements above designated.” By operation of Rule 35(b), respondent accepted 19 of petitioner’s statements in their entirety and partially accepted petitioner’s five remaining statements. Respondent had not offered any testimony in rebuttal of the testimony of petitioner’s witnesses. The Tax Court ignored its own Rule 35(b) in failing to adopt such accepted statements of fact in its findings of fact, and failed to refer to or explain its failures so to do either in its opinion or elsewhere, notwithstanding the petitioner, in its answering brief, expressly claimed the benefit of Rule 35(b). [R. 63.] The Tax Court findings not only failed to include petitioner’s con-

ceded statements of fact but such findings were in material respects inconsistent therewith. This entire matter was called to the Tax Court's attention by petitioner in its aforesaid motion for rehearing *de novo*. [R. 63.]

The question presented is: Did the Tax Court's failure, and subsequent refusal to apply its own Rule 35(b), under the circumstances, constitute prejudicial and reversible error, even apart from the other errors relied upon?

4. The next question for review is—

Under Section 23(a)(1)(A), Internal Revenue Code, were salary or compensation payments of \$28,000 each to petitioner's two managing officers, Cunningham and Morse, reasonable in amount and deductible in their entirety in computing petitioner's 1942 income? The entire evidence has been brought up for review.

On its return for 1942, petitioner claimed a deduction for \$56,000, representing \$28,000 each, incurred and paid by petitioner to Walter J. Cunningham and Elmer D. Morse, its two managing officers, during 1942, pursuant to previous corporate authorization therefor, for services actually performed by them. Respondent, in his statutory notice of deficiency, determined that only \$10,000 for each of the two officers was allowable as a deduction to petitioner for tax purposes for 1942. Petitioner petitioned the Tax Court to redetermine respondent's deficiency determination, and the Tax Court (by Judge Harlan) affirmed the two \$10,000 salary allowances and disallowed the remaining \$36,000 of the aggregate salary deductions of \$56,000 claimed in petitioner's return. In this pro-

ceeding for review, petitioner still claims that it is entitled to deduct the full \$56,000 of compensation incurred and paid by it to Mr. Cunningham and Mr. Morse in 1942, pursuant to corporate authorization therefor, for services actually rendered. We challenge Judge Harlan's adverse findings and conclusions as being clearly erroneous.

5. On April 18, 1947, petitioner filed a motion to correct the decision entered April 10, 1947, which motion was denied on April 21, 1947, by Judge Harlan. [R. 67-68.] The ground of the motion was that the Tax Court failed, in entering its decision under Rule 50, to allow or make proper adjustment in its deficiency computation for the ten per cent (10%) post-war credit of \$4,944.01 provided for under Sections 780 and 781, Internal Revenue Code, and set forth in respondent's computation for entry of decision [R. 229, before this Court in original form]. The question with respect to this matter is: Was it error for the Tax Court to have failed to give effect, in its decision redetermining the tax deficiency, to this concededly necessary adjustment in connection with the tax resulting from its affirmance of respondent's action in disallowing an aggregate of \$36,000 of the disputed salary deductions?

Statutes, Regulations, etc., Involved.

These are set forth in the Appendix, *infra*.

Specification of Errors Relied Upon.

The assignments of error relied upon are set forth in the record at pages 74-76 and 223-225, respectively. Petitioner relies upon the errors so assigned, but for convenience summarizes them as follows:

The Tax Court erred—

1. In permitting, contrary to law and the “due process” requirement, the determination of the proceeding by a judge who did not try the case, hear the evidence or observe the witnesses. [Assignments 2, 4; R. 74, 223.]

2. In denying petitioner’s motion for rehearing *de novo*, where the proceeding was determined by a judge who did not try the case. [Assignment 3; R. 74, 223.]

3. In failing to allow to petitioner, in its decision entered pursuant to Rule 50, the ten per cent (10%) post-war credit of \$4,944.01 admittedly allowable under Sections 780 and 781, Internal Revenue Code, and in denying petitioner’s motion to correct its decision in respect thereof. [Assignment 1; R. 74, 223.]

4. In failing to make findings in accordance with certain undisputed facts proved by the evidence, where respondent had by virtue of Tax Court Rule 35(b) conceded the correctness of petitioner’s statements of such facts. [Assignments 10, 11; R. 76, 223.]

5. In making findings contrary to the undisputed testimony of petitioner’s witnesses, where the judge making such findings had no opportunity to judge the credibility of such witnesses. [Point (f); R. 224-225.]

6. In that its findings of fact are clearly erroneous in the following material respects:

(a) The finding and holding that “a reasonable allowance for salary for the services rendered by

Walter J. Cunningham and Elmer D. Morse to the petitioner * * * during the year 1942 was \$10,000 per annum for each” is not supported by the evidence and is contrary to the undisputed evidence. [Point (d); R. 224.]

(b) In holding and concluding [R. 60] that “the evidence presented indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends,” in view of the fact that no such issue was presented by the original or amended pleadings, and respondent had not assigned any such contention in his deficiency determination. [Assignment 9; R. 75-76, 223.]

7. In failing to find the following material facts, which were proved by undisputed evidence:

(a) That petitioner would have been obliged to pay more than \$42,000 to others, if it had hired such other persons to perform the services which Cunningham rendered for petitioner in 1942. [Assignment 11; R. 76, 223.]

(b) That not less than \$28,000 was a reasonable allowance for salary for services rendered by Cunningham to petitioner in 1942. [Point (g); R. 225.]

(c) That \$28,000 was a reasonable allowance for salary for services rendered by Morse to petitioner in 1942. [Point (g); R. 225.]

(d) That all facts as stipulated were true. [Assignment 8; R. 75, 223.]

8. In entering decision for respondent and in failing to find and conclude that there were no deficiencies in tax due from petitioner for 1942. [Points (a), (b) and (c); R. 224.]

Summary of Argument.

Petitioner was entitled to have this proceeding both "heard and determined" by Judge Black, to whom it was assigned, and was deprived of "due process" by virtue of the failure of the Tax Court to comply with mandatory statutory requirements in respect thereof.

Petitioner's motion for rehearing *de novo* should have been granted on the grounds set forth therein.

Assuming, *arguendo*, that a deficiency existed for 1942, petitioner was entitled to a 10 per cent post-war credit thereagainst and its motion to correct the Tax Court's decision to give effect thereto should have been granted.

The compensation of \$28,000 each paid to Cunningham and Morse for 1942 was not in excess of reasonable compensation for services rendered by them and should have been allowed by the Tax Court, in view of the undisputed evidence.

The Tax Court should have found the facts as stipulated, as conceded by respondent by operation of Tax Court Rule 35(b), and as required by the undisputed evidence.

The Tax Court's findings and conclusions concerning the material and ultimate facts are clearly erroneous and its decision thereon should be reversed.

ARGUMENT.

I.

The Tax Court Erred in Permitting, Contrary to Law and the “Due Process” Requirement, the Determination of the Proceeding by a Judge Who Did Not Try the Case, Hear the Evidence, or Observe the Witnesses.

On June 18, 1946, this proceeding was heard by Judge Eugene Black on the merits. [R. 2.] Four witnesses testified on behalf of petitioner. [R. 100 to 218.] A partial stipulation of facts and numerous exhibits were filed. [R. 24-45, 91, 90-218.]

On January 17, 1947, memorandum findings of fact and opinion by Judge Byron B. Harlan were entered. [R. 3, 47-61.]

The record of docket entries from June 18, 1946, to January 17, 1947, inclusive [R. 2-3], does not disclose that any order was made by the Presiding Judge of the Tax Court, by Judge Black, or by any other judge, transferring the cause from Judge Black, who heard the evidence, to Judge Harlan, who did not.

The record is likewise silent as to any notice to petitioner that Judge Black would not determine the proceeding or that Judge Harlan would determine it. No such notice was ever given.

Moreover, the record does not show that petitioner stipulated or otherwise consented to the determination of the proceeding by Judge Harlan, and in fact, no such stipulation was ever made or consent given.

On February 12, 1947, petitioner transmitted to the Tax Court a motion for rehearing *de novo*, which was denied on February 17, 1947. [R. 61-65.] Said motion

was based on the grounds that Judge Harlan had no authority or power to determine the proceeding and that petitioner was materially prejudiced and aggrieved by his attempted exercise of jurisdiction. [R. 61-65.] The motion also specifically called attention to the above-mentioned state of the record and docket.

We contend that the determination of petitioner's proceeding by Judge Harlan constituted a violation of the "due process" clause, and that the Tax Court also violated the provisions of Sections 1116, 1117(b) and 1118(b), Internal Revenue Code (Appendix, *infra*), in permitting the determination of the case by a judge who did not try it. Our motion for rehearing also embodied the latter grounds.

It is well established that the constitutional requirement of due process is binding on the Tax Court, whether that tribunal be considered an administrative agency or a court.

Apropos here, is *Morgan v. United States*, 298 U. S. 468, in which it was held that an order of the Secretary of Agriculture fixing and determining maximum rates to be charged by market agencies for buying and selling livestock at Kansas City Stock Yards was void because the Secretary, without hearing the evidence, undertook to make the findings and fix the rates. The hearing directly involved "the *reasonableness* of existing rates." (Italics supplied.) (P. 472.) Appellants attacked the order "as illegal and arbitrary and as depriving (appellants) of their property without due process of law in violation of the Fifth Amendment of the Constitution."

The Supreme Court held (p. 477) :

“These suits for the review of the administrative action were thus directly authorized and appeal lies under the Urgent Deficiencies Act of October 22, 1913. * * * All questions touching the regularity and validity of the proceeding before the Secretary are open to review. * * * When the Secretary acts within the authority conferred by the statute, his findings of fact are conclusive. * * * But, in determining whether in conducting an administrative proceeding of this sort the Secretary has complied with the statutory prerequisites, the recitals of his procedure cannot be regarded as conclusive. Otherwise the statutory conditions could be set at naught by mere assertion. If upon the facts alleged, the ‘full hearing’ required by the statute was not given, plaintiffs were entitled to prove the facts and have the Secretary’s order set aside. Nor is it necessary to go beyond the terms of the statute in order to consider the constitutional requirement of due process as to notice and hearing. For the statute itself demands a full hearing and the order is void if such a hearing was denied. * * *

“What is the essential quality of the proceeding under review, and what is the nature of the hearing which the statute prescribes?

“The proceeding is not one of ordinary administration, conformable to the standards governing duties of a purely executive character. It is a proceeding looking to legislative action in the fixing of rates of market agencies.

“A proceeding of this sort requiring the taking and weighing of evidence, determinations of fact based upon the consideration of the evidence, and the

making of an order supported by such findings, has a quality resembling that of a judicial proceeding. Hence it is frequently described as a proceeding of a *quasi-judicial* character. The requirement of a 'full hearing' has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the trier of the facts. The 'hearing' is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations which in other fields might have play in determining purely executive action. The 'hearing' is the hearing of evidence and argument. If the one who determines the facts which underlie the order has not considered evidence or argument, it is manifest that the hearing has not been given.

"There is thus no basis for the contention that the authority conferred by Sec. 310 of the Packers and Stockyards Act is given to the Department of Agriculture, as a department in the administrative sense, so that one official may examine evidence, and another official who has not considered the evidence may make the findings and order. In such a view, it would be possible, for example, for one official to hear the evidence and argument and arrive at certain conclusions of fact, and another official who had not heard or considered either evidence or argument to overrule those conclusions and for reasons of policy to announce entirely different ones. It is no answer to say that the question for the court is whether the evidence supports the findings and the findings support the order. For the weight ascribed by the law to the findings—their conclusiveness when made within the sphere of the authority conferred—rests upon

the assumption that the officer who makes the findings has addressed himself to the evidence and upon that evidence has conscientiously reached the conclusions which he deems it to justify. That duty cannot be performed by one who has not considered evidence or argument. It is not an impersonal obligation. It is a duty akin to that of a judge. The one who decides must hear.

“This necessary rule does not preclude practicable administrative procedure in obtaining the aid of assistants in the department. Assistants may prosecute inquiries. Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical. But there must be a hearing in a substantial sense. And to give the substance of a hearing, which is for the purpose of making determinations upon evidence, the officer who makes the determinations must consider and appraise the evidence which justifies them. That duty undoubtedly may be an onerous one, but the performance of it in a substantial manner is inseparable from the exercise of the important authority conferred.”

We have quoted from the *Morgan* case at length as a substitute for argument by us, since we could never express the thoughts of Mr. Chief Justice Hughes on the important “due process” question here involved, in more lucid or forceful language than he employed.

The instant proceeding before the Tax Court was, to say the least, “a proceeding of a *quasi-judicial* character.” The Tax Court certainly exercised judicial functions; it is called a “court” and its members are called “judges.”

Section 1116, Internal Revenue Code (Appendix, *infra*), requires that the hearing before a division of the Tax Court shall be a public hearing. Certainly, the hearing before the Tax Court is to be of no less dignity than the hearing discussed above in the *Morgan* case.

Section 1117(b), Internal Revenue Code, provides:

“INCLUSION OF FINDINGS OF FACT OR OPINIONS IN REPORT.—*It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions.*” (Italics supplied.)

Section 1118(a), Internal Revenue Code, provides:

“HEARINGS, DETERMINATIONS, AND REPORTS.—*A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.*” (Italics supplied.)

Pursuant to Section 1103, Internal Revenue Code, Judge Eugene Black was designated and assigned by the Presiding Judge of the Tax Court as a one-judge Division to hear and determine, among others, petitioner's proceeding at Los Angeles in June, 1946. [R. 61-62.] According to C. C. H. Tax Court Reporter's weekly reports published February 15, 1946, and August 2, 1946, respectively, the Presiding Judge “divided the Tax Court into one-member Divisions, each authorized to hear and decide cases. * * * Division assignments are as follows (as of February 15, 1946): * * * Division 11 * * *

Arthur J. Mellott * * * Division 15 * * * Eugene Black.” As of August 2, 1946, according to the C. C. H. report, “Division assignments are as follows: Division 11 * * * Byron B. Harlan” (term commenced June 2, 1946); “Division 15 * * * Eugene Black.”

The current C. C. H. Tax Reporter shows that Judges Harlan and Black still are assigned to Divisions 11 and 15, respectively.

From all of the foregoing, it is clear that petitioner was entitled to a public hearing at which the judge assigned to try petitioner's proceeding was charged by law with the duty both of hearing the evidence and determining the issues involved by making, initially at least, the findings of fact and entering conclusions of law thereon.

The power of this Court to review the regularity and validity of the proceeding below is conferred by Section 1141, Internal Revenue Code, which provides:

“The Circuit Courts of Appeal * * * shall have exclusive jurisdiction to review the decisions of the Tax Court, * * * , in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgments of any such court shall be final, * * *.”

Proceedings before the Tax Court are thus unquestionably placed upon the same footing as those before other courts. This is also true insofar as the due process requirement of the Fifth Amendment to the Constitution is concerned.

And, as Mr. Chief Justice Hughes stated (p. 477):

“All questions touching the regularity and validity of the proceeding * * * are open to review.”

In judicial proceedings, the cases are universally to the following effect, as held by the Supreme Court of California in *In re Sullivan*, 143 Cal. 462, 77 Pac. 153, 155:

“A party litigant is entitled to a decision upon the facts of his case from the judge who hears the evidence, where the matter is tried without a jury, and from the jury that hears the evidence, where it is tried with a jury. He cannot be compelled to accept a decision upon the facts from another judge or another jury.”

In *Clanton v. Ryan*, 14 Colo. 419, 24 Pac. 258, 259, it was held:

“It certainly is not ‘according to the rules and practice’ in the trial of ordinary civil actions before a court of record for one judge to hear the evidence, or a part thereof, orally, and then for another judge to render a finding and judgment upon such evidence, however perfectly the same may have been preserved.”

The rule is the same in criminal cases. It was so held in *In re Williams*, 52 Cal. App. 566, 569, where the reason for the rule in civil cases is explained. We quote (pp. 569-570):

“The foregoing sections of the Penal Code clearly indicate to our minds that the essential procedure upon a preliminary examination of a felony charge does not differ materially from that required upon the trial of the cause. The magistrate who is to make the order either discharging the defendant or holding him to answer upon the charge must base that order upon evidence which he has admitted and upon testi-

mony which he has heard in the usual way in which such evidence is presented and such testimony taken. He has no right to predicate his said order upon something which has not occurred before him; upon evidence the admissibility of which he has not passed upon, and upon testimony the weight and value of which he has not measured by the appearance, the narration and the manner of testifying of the witnesses present in person before him. It has been expressly held that upon the trial of a cause in a superior court judges cannot be changed in the midst of a hearing with the effect that the substituted judge could be entitled to decide the cause upon evidence which he had not himself heard or passed upon (Guardianship of Sullivan, 143 Cal. 462, (77 Pac. 153)). We are satisfied that a like procedure must obtain upon the hearing of preliminary examinations.”

See also:

Connolly v. Ashworth, 98 Cal. 205, 33 Pac. 60;

City of Long Beach v. Wright, 134 Cal. App. 366,
370, 371;

La Bonte v. La Casse, 78 N. H. 489, 102 Atl. 540;

and cases cited under Argument II, *infra*.

It conclusively follows, from the foregoing, that petitioner was deprived of due process under the Fifth Amendment to the Constitution of the United States, by the erroneous attempt to assume jurisdiction by the judge who made the determination but who did not try the case, hear the evidence, or observe the witnesses. Likewise, the Tax Court violated Sections 1116, 1117(b) and 1118(a), Internal Revenue Code, *supra*.

II.

The Tax Court Erred in Denying Petitioner's Motion for Rehearing De Novo, Where the Proceeding Was Determined by a Judge Who Did Not Try the Case.

The facts sufficiently appear under Argument I, above. Petitioner gave the Tax Court ample opportunity to correct its error, by calling the matter promptly to its attention by a motion for a rehearing *de novo*.

The motion was denied by the same judge [R. 65] who, it is claimed by petitioner, had no power or authority to determine the proceeding, as demonstrated in the preceding argument.

It was error for the Tax Court to deny the motion, since a hearing *de novo* should have been granted under the circumstances. It was so held in *Wainwright v. P. H. & F. M. Roots Co.*, 176 Ind. 682, 97 N. E. 8, 14, where the Supreme Court of Indiana stated:

“A party to an action is entitled to a determination of the issues by the jury or judge that heard the evidence, and where a case is tried by the judge, and the issues remain undetermined at the death, resignation, or expiration of the term of such judge, his successor cannot decide, or make findings in the case, *without a trial de novo*. *Bahnsen v. Gilbert*, 55 Minn. 334, 56 N. W. 1117; *Clanton v. Ryan*, 14 Colo. 419, 24 Pac. 258; *Guardianship of Sullivan*, 143 Cal. 462, 77 Pac. 153; *Connolly v. Ashworth*, 98 Cal. 205, 33 Pac. 60; *Mace v. O'Reilley*, 70 Cal. 231, 11 Pac. 721; *Norvell v. Deval*, 50 Mo. 272, 11 Am. Rep. 413; *Weyman v. National Broadway Bank*, 59 How. Prac. (N. Y.) 331; *Putman v. Crombie*, 34 Barb. (N. Y.) 232; *Cain v. Libby*, 32 Minn. 491, 21 N. W. 739; *Ells v. Rector*, 32 Mich. 379; 23 Cyc. 565.” (Italics supplied.)

The Supreme Court of California similarly held in *Mace v. O'Reilly*, 11 Pac. 721, 723, where the following language appears:

“When that judge went out of office, the trial was incomplete, and no proper judgment could be entered. *It seems to us that a new trial was inevitable*, unless agreed findings should be filed or waived by both sides to the controversy. The motion to vacate the judgment, as made, was initiated within about seven days after its rendition.

“The fact that plaintiff did not formally move for a new trial, but chose rather to move to set aside and vacate the judgment, is of no material consequence. *A new trial was inevitable in either event*, and no error was committed by the court in setting aside the judgment for the want of findings. *Van Court v. Winterson*, 61 Cal. 615.” (Italics supplied.)

The following quotation from *McAllen v. Souza*, 24 Cal. App. 2d 247, 251, is to the same effect:

“In such cases it has been held, at least in the absence of consent or waiver, that no other judge may render a valid judgment *without a trial de novo*, for ‘A party litigant is entitled to a decision upon the facts of his case from the judge who hears the evidence, when the matter is tried without a jury.’ (*Guardianship of Sullivan*, 143 Cal. 462, 467 (77 Pac. 153); see, also, *Connolly v. Ashworth*, 98 Cal. 205 (33 Pac. 60).) In *Hughes v. De Mund*, *supra*, at page 368, the court quoted with approval from 33 Corpus Juris, page 973, as follows: ‘Where a case is tried by the judge, and the issues remain undetermined by him, his successor cannot decide, or make findings in the case, *without a trial de novo*, and consequently he cannot, in such a case, render a valid

judgment or decree in the cause, notwithstanding the testimony may have been written down and preserved.’” (Italics supplied.)

The jealousy with which the courts of this state safeguard the right to have the trier of facts make findings and decisions thereon is best exemplified in the opinion of the Supreme Court of California in *Francis v. Superior Court*, 3 Cal. 2d 19, 28, 29. There the Supreme Court upheld the trial judge’s punishment for contempt of attorneys for both parties who had stipulated to have a motion for a new trial heard and granted by a judge who did not try the case. The Supreme Court there stated:

“It needs no argument, we think, to prove that a judge who has heard the evidence, examined the witnesses and made a study of the law applicable to the facts in the case, is best qualified to rule upon the weight and value of the testimony of such witnesses as well as upon other questions presented by the motion and which were involved in the trial of the action and to which the trial judge in most instances has given his attention and studious consideration. To have a motion for new trial heard by a judge familiar with the facts and law of the case, rather than by one totally unfamiliar with such facts and who has made no special study of the law applicable to those facts, was the very essence of Section 661 of the Code of Civil Procedure. Its requirements were therefore mandatory according to the established rule announced above.”

In the instant case, the motion for a rehearing *de novo* should properly have been heard by Judge Black, who tried the case. In any event, it should have been granted, and the denial of petitioner’s motion constituted prejudicial and reversible error.

III.

The Tax Court Erred in Denying Petitioner's Motion to Correct Its Decision in Respect of the Ten Per Cent Post-War Credit.

Solely on the assumption, *arguendo*, that a deficiency in petitioner's excess profits tax existed for 1942, the Tax Court erred in failing to allow the 10 per cent post-war credit there against or to make proper adjustment or provision therefor in its decision ostensibly based on respondent's proposed recomputation under Rule 50 of the Tax Court. Actually, in Respondent's Recomputation for Entry of Decision [before this Court in original form, pursuant to order, R. 229], respondent conceded by the following statement on page 2 of its attached recomputation statement, that petitioner was entitled to such credit:

“Excess profits tax, schedule 5.....\$49,440.07
Credit allowable under sections 780 and
781 (10% of \$49,440.07)..... \$4,944.01”

The Tax Court further erred in denying [R. 68] petitioner's motion [R. 67-68] to correct its decision in respect of this matter when its failure to allow such credit, despite respondent's aforesaid concession in his recomputation, was specifically called to its attention. Petitioner made this motion to correct and revise pursuant to Tax Court Rule 19, which allows such motions.

Although the excess profits tax provisions have been repealed and do not apply to any taxable year beginning after December 31, 1945, we are concerned here with Sections 780 and 781, Internal Revenue Code.

The pertinent part of Section 780, Internal Revenue Code, provides as follows:

“(a) *In General.*—The Secretary of the Treasury is authorized and directed to establish a credit to the account of each taxpayer subject to the tax imposed under this subchapter, for each taxable year ending after December 31, 1941 * * * and not beginning after December 31, 1943, of an amount equal to 10 per centum of the tax imposed under this subchapter for each such taxable year. * * *”

We contend that it was the duty of the Tax Court in its decision to determine the net deficiency, after giving effect to the 10 per cent credit provided for by Section 780, Internal Revenue Code. The 10 per cent credit operates automatically as a percentage reduction of any gross amount of excess profits taxes computed. Our position is substantiated by the following language of the Tax Court in *Altschul's, Inc.*, 9 T. C. 697, 699-700:

“Section 780 (a), as amended, provides the post-war credit to the account of each taxpayer ‘subject to the tax imposed under this subchapter * * * of an amount equal to 10 per centum of the tax imposed * * *.’ When the tax is ‘imposed’ the taxpayer becomes entitled, under the statute, to the credit, and the limitation placed on the amount of the credit in section 781 (d) (not applicable to *Walt's, Inc.*) is only a limitation on the amount, and is not a condition precedent to the existence of the credit.
* * *

“That it was not the intention of Congress that the right to the credit be postponed until the taxes were paid appears not only from the language of the statute itself, but from a later statement by the Ways and Means Committee (Report, Revenue Act of

1943, p. 60) that 'Since the post-war credit is tentatively determined on the basis of the excess profits tax shown on the return,' provision was made for the adjustment upward or downward of the credit in the event of an upward or downward revision of the tax liability upon which it is based.

“* * *

“Reviewed by the Court.”

The statutory plan at first provided for the issuance to taxpayers of the United States of bonds equal to 10 per cent of the excess profits taxes paid by each taxpayer. (Sec. 780, I. R. C.)

Subsequently, Section 781 (c), Internal Revenue Code, was amended by the 1945 Tax Adjustment Act to provide, in part, as follows:

“(c) * * * If after January 1, 1946, there is any credit under section 780 (a) remaining in favor of the taxpayer attributable to any taxable year for which a credit is provided in section 780 (a), such remainder shall be paid to the taxpayer in cash. No amount of any payment made under this subsection to a taxpayer shall be included in gross income.”

From the foregoing, it is clear that at the time of the Tax Court's decision herein, it was not required that a taxpayer must first pay an excess profits tax deficiency for 1942 as a condition to eligibility for the credit.

It follows that the credit should have been awarded by the Tax Court in reduction of whatever excess profits tax deficiency it determined. The Tax Court erred in failing so to do and in denying petitioner's motion to correct its decision in respect thereof.

IV.

The Tax Court Erred in Failing to Find, in Accordance With the Undisputed Evidence, That Petitioner Would Have Been Obligated to Pay More Than \$42,000 to Others, if It Had Hired Such Other Persons to Perform the Services Which Cunningham Rendered for Petitioner in 1942.

The following facts, among others, proved by petitioner, were not contradicted by respondent, since he offered no testimony in rebuttal:

During 1942, Cunningham did all of petitioner's metallurgical work, acted as shipping clerk, general manager of the production end of petitioner's business [R. 121-122], inspector of castings, superintendent of production [R. 123-124], pattern-maker [R. 172-173], salesman [R. 124-125], sometimes invoice clerk [R. 174], and, in addition, all of the duties of Cunningham and Morse overlapped [R. 123]. Cunningham also served as president and a director, as previously stated.

During 1942, Morse, in addition to his overlapping duties [R. 123], handled the scheduling of parts out of the foundry, the financing of petitioner's business, the payrolls, office details of every description [R. 122-123], manager [R. 215] and performed the duties of secretary and treasurer, as well as those of a director of petitioner. He also personally guaranteed bank loans to petitioner [Stip. 9] pending the establishment, through Morse's efforts, of a line of credit with the Bank of America [Stip. 17, R. 52].

Had petitioner employed a metallurgist to do Cunningham's work, \$55 a week (\$2,860 a year) would have been a low salary. [R. 173-174.] A shipping

clerk would have cost petitioner \$1.15 to \$1.20 an hour [R. 173], or \$1,500 a year for 4 hours a day; an inspector of castings \$350 to \$450 a month [R. 123-124], or \$4,200 to \$5,400 a year; a superintendent of production \$1,000 a month [R. 124], and a salesman at least 5%* of petitioner's gross sales [R. 124-125, 195-196, 207-208], or \$22,000 for 1942, and \$48,000 for 1943 [Stip. Ex. 7-G]. Five guards would have cost an aggregate of \$5 an hour (day and night), which expense was eliminated by using eight of petitioner's own employees. [R. 125-126.] This saving was at least \$100 a day. Cunningham believed petitioner would have had to pay to others for services similar to those rendered by Morse in 1942, every dollar which it paid to Morse. [R. 125-126.]

The Tax Court's findings against petitioner are inconsistent with the foregoing undisputed evidence.

The decisions of all of the courts are in agreement that findings of fact must be made in accordance with a petitioner's uncontradicted evidence. To make findings otherwise is to commit reversible error. In *Planters' Operating Co. v. Commissioner of Internal Revenue* (C. C. A. 8), 55 F. 2d 583, 584, 585, the rule is succinctly stated:

"It is well established:

"* * *

"That it is reversible error for the Board of Tax Appeals to disregard competent relevant testimony when it is not contradicted. *Chicago, etc., Co. v. Blair* (C. C. A.) 20 F. (2d) 10; *Boggs & Buhl v.*

*Cunningham and the two absolutely disinterested witnesses White and Temple testified to this same effect.

Commissioner (C. C. A.) 34 F. (2d) 859; *Citrus Soap Co. v. Lucas* (C. C. A.) 42 F. (2d) 372; *Pittsburgh Hotels Co. v. Commissioner* (C. C. A.) 43 F. (2d) 345; *Dempster, etc., Co. v. Burnet* (App. D. C.) 46 F. (2d) 604; *Conrad & Co. v. Commissioner* (C. C. A.) 50 F. (2d) 576.”

The following explanatory statement in Volume 9, *Mertens Law of Federal Income Taxation*, pages 296 and 297, is supported by the authorities there cited:

“* * * The presumption that the Commissioner’s assessment of the tax is *prima facie* correct means no more than that, in the absence of evidence to the contrary, his action will be upheld, but, once there is such contrary evidence, this presumption vanishes and the case is wide open.⁵⁶ This presumption is what is often termed a ‘true’ presumption and is not evidence itself, but merely shifts the burden of *going forward with*, as distinguished from the *actual burden of*, proof; and once the burden of *going forward with* the proof is met, it is as though the presumption had never existed.⁵⁷ In other words, the effect of a presumption is little more than to cast upon the other party the burden of going forward. * * *.”

That the presumption of the correctness of the Commissioner’s determination does not constitute a species of *evidence* creating a conflict with the evidence to the contrary introduced by a taxpayer, which the Tax Court may resolve, is held by this Court in *J. M. Perry & Co., Inc. v. Commissioner*, 120 F. 2d 123, 124, where the following rule is enunciated:

“* * * This finding is presumptively correct, that is, until the taxpayer proceeds with competent and relevant evidence to support his position, the

determination of the Commissioner stands. When such evidence has been adduced the issue depends wholly upon the evidence so adduced and the evidence to be adduced by the Commissioner. *The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof. Welch v. Helvering*, 290 U. S. 111, 115, 54 S. Ct. 8, 78 L. Ed. 212; *Helvering v. National Grocery Co.*, 304 U. S. 282, 294, 295, 58 S. Ct. 932, 82 L. Ed. 1346; *Helvering v. Talbott's Estate*, 4 Cir., 1940, 116 F. 2d 160, 162. * * *

(Italics supplied.)

The nature of the presumption of the correctness of the Commissioner's determination is thus explained in *Wiget v. Becker* (C. C. A. 8), 84 F. 2d 706, 708, cited in note 56, referred to above:

“The presumption of correctness is in the class of the ‘burden of proof presumption.’ *Morrison v. People of California*, 291 U. S. 82, 54 S. Ct. 281, 78 L. Ed. 664; *Casey v. United States*, 276 U. S. 413, 48 S. Ct. 373, 72 L. Ed. 632. The party against whom it is invoked must fail if he does not produce evidence against it. It is often referred to in the books as the true presumption. ‘A true presumption is not evidence, though it supplies its place and requires the other party to proceed with the negative. Unless he does, he loses; when he does, the presumption is out of the case, and the issue is open.’ *United States ex rel. v. Pulver* (C. C. A. 2) 54 F. (2d) 261, 263. See, also, *United States v. Le Duc* (C. C. A.

8) 48 F. (2d) 789; *Fidelity & Cas. Co. v. Niemann* (C. C. A. 8) 47 F. (2d) 1056; *Del Vecchio v. Bowers*, 296 U. S. 280, 56 S. Ct. 190, 193, 80 L. Ed. 229.”

In *Whitney v. Commissioner*, 73 F. 2d 589 (C. C. A. 3), the following applicable rule is stated:

“The Board (of Tax Appeals) and this court in reviewing the order of redetermination are confined to the facts set out in the record. The burden of proof was on the petitioner before the Board, and *if he met it, the burden shifted and the government was required to come forward with evidence to refute the evidence of the petitioner.* It did not do so and the Board cannot draw inferences and conclusions from facts or suppositions outside of the record.” (Italics supplied.)

When petitioner in the instant case completed its evidence, respondent failed “to come forward with evidence to refute the evidence of the petitioner.”

Moreover, the judge who made the findings here arbitrarily disregarded the testimony of petitioner’s unimpeached witnesses, in that he failed to take into consideration that a witness is presumed to speak the truth. Apparently, a contrary presumption was applied to petitioner’s witnesses.

In failing to make findings of fact in accordance with petitioner’s undisputed evidence, the judge who determined the proceeding, likewise, failed to take into consideration

the purpose, and to avail himself of the benefits, of Tax Court Rule 35(b), which provides:

“(b) The party having the burden of proof shall set forth complete statements of the facts based upon the evidence. Each statement shall be numbered, shall be complete in itself, and shall consist of a concise statement of the essential fact and not a discussion or argument relating to the evidence or the law. Reference to the pages of the transcript or the exhibits relied upon in support thereof shall be inserted after each separate statement.

“If the other party disagrees with any or all of the statements of fact, he shall set forth each correction which he believes the evidence requires and shall give the same numbers to his statements of fact as appear in his opponent’s brief. His statement of fact shall be set forth in accordance with the requirements above designated.”

Petitioner, in obedience to the above rule, set forth numbered “statements of the facts based upon the evidence,” with appropriate record references.*

Respondent, in his brief, failed to follow Rule 35(b), but partially disagreed with petitioner’s statements numbered 6, 8, 9, 10 and 21, in its so-called “request for findings of fact,” which is not provided for by the Tax Court rules.

*The briefs filed in the Tax Court were not transmitted to the Clerk of this Court with the record. Petitioner intends to move this Court that the record be augmented to include pertinent and necessary portions of such briefs, unless respondent in its brief will concede the correctness of our statements above set forth.

By failing to disagree with petitioner's statements of facts numbered 1, 2, 3, 4, 5, 7, 11 to 20, both inclusive, 22, 23 and 24, respondent, by operation of Rule 35(b), admitted the correctness of petitioner's statements, thus numbered. (Statements numbered 18 and 19, are set forth, *verbatim*, at the commencement of this argument, with present record references.)

Rule 35(b) was undoubtedly designed to narrow the issues of fact to be determined by the trial judge in making his findings of fact.

Where the facts were not contradicted and where respondent thus conceded the correctness of petitioner's statements, it was manifest error for the Tax Court to fail to make findings in accordance with such evidence. The Tax Court should have found that Cunningham's services made a saving in other salaries to petitioner of more than \$42,000. This alone justified the payment to Cunningham of the additional \$18,000 which was disallowed by respondent.

Despite the fact that the evidence was uncontradicted and despite Tax Court Rule 35(b), the judge making the determination held [R. 60] "that an unimpressive attempt was made to prove that the petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham, . . ."

The prejudicial error committed by the Tax Court is self-evident.

V.

The Compensation Payments in 1942, of \$28,000.00 Each to Petitioner's Two Managing Officers, Cunningham and Morse, Were Not in Excess of a Reasonable Allowance for the Services Actually Performed by Them, and All Findings and Conclusions to the Contrary Are Clearly Erroneous.

Section 23(a)(1)(A), Internal Revenue Code (Appendix, *infra*), provides that in computing net income there shall be allowed as deductions from gross income—

“All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *”

The applicable Treasury regulations (Regs. 103, Sec. 19.23(a)-6) (Appendix, *infra*), are to the same effect and provide further that—

“The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.”

Whether compensation is “reasonable” within the meaning of the foregoing applicable provisions is a question to be determined by the particular facts and circumstances disclosed by the evidence in each case.

In this case, the evidence disclosed (1) the duties of the two managing officers and the services performed by each; (2) their abilities to perform those services; (3) the time they devoted to petitioner's business and operations; (4) the success resulting from employment of their ingenuity,

background of experience, ability, and services; (5) their acceptance of insufficient compensation in immediately preceding periods; (6) the even greater aggregate compensation which would have had to be paid to competent employees for services similar to those performed by petitioner's managing officers, etc.

Cunningham, petitioner's president, never had been a stockholder. [R. 114, 163, 211; see Stip., R. 27.] Nor had he loaned any money to petitioner. [R. 163, 217.] His wife was a stockholder [R. 27], but she did not purchase her stock with funds furnished by her husband. She borrowed from her father. [R. 145, 213.] She did considerable work for petitioner during 1942 for which she neither asked for nor received any compensation [R. 215-216], except for \$250.00 in director's fees for ten meetings held between August 28 and December 30, 1942 [R. 218].

It conclusively follows that, as hereinafter shown, despite the Tax Court's conclusion in its opinion to the contrary [R. 60], the salary of \$28,000.00 paid Cunningham in 1942 bore no relation to any stock ownership by him and did not represent a distribution of profits in the guise of salary, but was paid solely for services actually rendered. The Tax Court's finding [R. 60] in this connection is clearly erroneous [Assignment 9, R. 75-76].

Morse, petitioner's secretary and treasurer, was a stockholder [R. 27] who extended to petitioner his personal credit on bank loans until petitioner's separate credit was established [R. 29]. He was a person of means, of wide business and financial experience [R. 120], and was the owner of a number of sporting goods stores at the time he became associated with petitioner in 1941 [R. 157]. His wife loaned petitioner \$8,500.00 in 1941 [R. 157], but

she never was a stockholder [R. 27]. Morse, however, was a stockholder.

Together, Cunningham and Morse were charged with the management of petitioner's business and affairs. [Ex. L, p. 3, before this Court in original form, pursuant to order, R. 229.] It was so ordered by the directors in their meeting of March 31, 1941 [Ex. L, *supra*], and they did jointly manage petitioner's business and operations.

Petitioner's steadily increasing profits resulted chiefly from the combined ingenuity, abilities, time, energies, and activities of Cunningham and Morse as officer-employees. Their duties and abilities to perform their duties were the causal factors in petitioner's success. The war created a world-wide condition which, while it may have affected many manufacturing businesses somewhat favorably, also multiplied immeasurably their business hazards and management duties and responsibilities. However, the war did not remove competition in petitioner's field. Ability, hard work, sweat, and toil remained the indispensable causal factors in the success attained by Cunningham and Morse for petitioner. Petitioner was not a "war baby," nor can it truthfully be said that the war economy was the primary occasion for its success. It was incorporated April 24, 1940, and its organization meeting was held April 25, 1940. [R. 24-25.]

During 1942, according to the disinterested witness Temple, who was buyer for North American Aircraft Company near Los Angeles, which purchased from petitioner, "there was a great deal of competition" in the aluminum business on the part of the various foundries for the furnishing of aircraft parts. [R. 198-199.] Temple testified [R. 199] that North American had salesmen calling on it every day trying to sell it aluminum castings and

that it was impossible to give all of them orders. Temple's testimony was not contradicted.

Cunningham had charge of petitioner's sales and sales promotion [R. 124-125], for which he was well qualified from past extensive sales experience with manufacturing purchasers. He testified [R. 148] it was a backbreaking job building a foundry, and that if he had had in mind that aircraft would win the war he would have gone into an easier line of endeavor. Furthermore, competition became keener in 1942 because the Alcoa aluminum heat treating process was made available, without royalties, by government direction to all who cared to use it. [R. 155.]

Petitioner's gross sales jumped from \$1,227.38 for 1940 [R. 33] to \$964,862.25 for 1943 [R. 42]. Its 1942 gross sales were \$434,363.44 [R. 33, 38], whereas its 1941 gross sales were \$39,996.19 [R. 33, 37]. In 1940, it sustained an operating loss of \$1,123.58. [R. 33.] These progressive sales increases clearly were the result of the capable efforts, abilities, and tireless energies of the two managing officer-employees.

In 1941, Cunningham and Morse were faced with the problems of establishing a new foundry plant [R. 28], of building and training entirely new personnel, obtaining the necessary priorities, and the many other difficult details incident to what was the equivalent of establishing a new manufacturing business [R. 121-122].

During 1942, Cunningham and Morse each devoted to petitioner's business and operations 12 to 14 hours a day, seven days a week in many instances, and did night work. [R. 33-34, 125.] This is the equivalent of compressing 18 to 24 months of service into 12 months.

Even during 1941, each devoted his full time to petitioner's business and operations, and received therefor as

compensation the inadequate sum of \$1,650. [Stip. 19, R. 33.] For 1940, no salaries whatsoever were paid by petitioner to any of its officers or directors. [Stip. 19, R. 33.]

While Cunningham and Morse jointly managed the affairs and business of petitioner [Ex. L, p. 3], and their duties overlapped, the evidence discloses without contradiction that had petitioner employed a metallurgist, a shipping clerk, an inspector of castings, a superintendent of production and a salesman, to perform those services, it would have cost petitioner considerably more than \$42,000 therefor, as shown in Argument IV hereof. Obviously, these and the overlapping executive and managerial duties of Cunningham and Morse were worth well in excess of the aggregate amount of \$56,000 actually paid to them. Services such as they performed could not have been procured for less.

It should be borne in mind that Cunningham and Morse enlarged petitioner's new plant from a structure 40 by 60 feet to 80 by 165 feet and equipped it. This expansion was accomplished with small capital earnings and borrowings. Moreover, the addition to petitioner's earned surplus for the year 1942, after payment of taxes and salaries, amounted to approximately \$9,000, or six times the \$1,500 of capital stock outstanding. In other words, there remained net earnings of \$60 for each \$10 par value share of stock. The non-payment of dividends in 1942 may be justified and explained by the fact loans for plant expansion purposes were outstanding and had to be repaid. The working capital needs incident to the production of \$964,862.25 of gross sales for 1943, more than

twice those of 1942, are clearly apparent. Thus, further explanation for non-payment of dividends in 1942 becomes unnecessary.

It is important to note that the directors voted at least \$24,000 of the disputed salaries to each of its two managing officer-employees at the very beginning of the year, *viz.*, on January 5, 1942. [R. 30.] Increases, resulting in the aggregate payment of \$28,000 to each officer for 1942, were voted on August 28, 1942, effective as of September 1, 1942. [R. 31.] Both actions by the directors occurred before the year's earnings possibly could be known. This clearly negatives any inference, such as drawn by the Tax Court, that there was a purpose to distribute profits rather than fix reasonable compensation for services.

Moreover, respondent never placed in issue by his answer, or any amendment thereto, the contention that profits or dividends were distributed under the guise of compensation, or salaries. The Tax Court exceeded its authority, therefore, and erred in injecting, and assuming such issue to be involved, in the case. In *Heckett v. Commissioner*, 8 T. C. 841, 844, where respondent in his brief before the Tax Court raised for the first time a contention that certain proceeds from stock should not be treated as payment of salary, the Court held (p. 844) that the pleadings did not cover such question, and as respondent had not injected the question into the proceeding "at the trial, at the latest, as required by the rules of the Court," by moving to amend his answer, the issue "is not properly before" the Tax Court and will not be considered.

When fixing the officers' salaries involved herein, the directors believed them to be fair and reasonable, and so testified. [R. 176-178, 214-216, 163-164.] In this re-

spect, their opinions and action should be controlling in the absence of any contradictory evidence—and there is none.

A case substantially parallel to the case at bar is *Coastal Stevedoring Corp. v. Commissioner*, 3 T. C. M. 453, Docket No. 638, decided May 12, 1944 (C. C. H. Dec. 13,933(M)), in which a \$35,000 salary was allowed by the Tax Court to each of taxpayer's two managing officers, and the net income remaining was \$28,010.30, the gross receipts were \$305,861.60, the increase to earned surplus for the taxable year was approximately \$7,000 and no dividends were paid. The taxpayer obtained a new employment during the taxable year, which considerably increased its receipts. The Commissioner disallowed \$15,000 of each of the two \$35,000 salaries claimed, and the Tax Court sustained each \$35,000 salary as reasonable, notwithstanding the fact each officer owned half of the ten outstanding shares of stock and their salaries had risen from \$5,500 each in 1935 to \$35,000 in 1941, the taxable year.

In the instant case, petitioner's net income remaining after \$56,000 of officers' salaries, and directors' fees, was \$29,828.39, the gross receipts were \$434,363.44, the increase to earned surplus for the taxable year was about \$9,000, only one of the two managing officers was a stockholder, and the salaries were only \$28,000 each.

Here, as in the *Coastal Stevedoring* case, *supra*, the Commissioner's reduction of the salaries paid is not explained in the deficiency notice except that the amount disallowed is determined to be "excessive" compensation for the "services rendered by" the "officers." [Ex. A of Petition, R. 16.]

It is submitted that the Tax Court's findings that \$10,000 each to Cunningham and Morse for 1942 consti-

tuted a reasonable allowance for services rendered, is contrary to the undisputed evidence and clearly erroneous [Point (d), R. 224]; also that the Tax Court clearly erred in failing to find and conclude that not less than \$28,000 to each was a reasonable allowance for salary for services rendered by Cunningham and Morse to petitioner in 1942, under uncontradicted evidence. [Point (g), R. 225; Assignments 11 and 13, R. 76.] Accordingly, the Tax Court erred in entering decision for respondent, in not entering decision for petitioner, and in failing to find and conclude that there were no deficiencies for 1942. [Points (a), (b) and (c), R. 224.]

Moreover, in the light of the pleadings, stipulated facts, the documentary evidence and undisputed testimony, the Tax Court's ultimate findings and conclusions are clearly without support. [Points (e) and (f), R. 224-225.]

Conclusion.

The decision of the Tax Court should be reversed and remanded with instructions that it enter its decision that there is no deficiency in respect of petitioner's 1942 profits taxes, or in the alternate, that a rehearing *de novo* be granted.

Respectfully submitted,

GEORGE H. ZEUTZIUS,

A. P. G. STEFFES,

Attorneys for Petitioner.

May, 1949.

APPENDIX.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

SEC. 1116. HEARINGS.

* * * Hearings before the Board and its division shall be open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. * * *

SEC. 1117. REPORTS AND DECISIONS.

* * * * *

(b) *INCLUSION OF FINDINGS OF FACT OR OPINIONS IN REPORT.*—It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions.

* * * * *

SEC. 1118. PROVISIONS OF SPECIAL APPLICATION TO DIVISIONS.

(a) HEARINGS, DETERMINATIONS, AND REPORTS.—A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

SEC. 1141. COURTS OF REVIEW.

(a) JURISDICTION.—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; * * *

Rules of Practice Before the Tax Court of the United States:

RULE 35.—BRIEFS.

The form of all briefs shall be as follows:

* * * * *

(b) The party having the burden of proof shall set forth complete statements of the facts based upon the evidence. Each statement shall be numbered, shall be complete in itself, and shall consist of a concise statement of the essential fact and not a discussion or argument relating to the evidence or the law. Reference to the pages of the transcript or the exhibits relied upon in support thereof shall be inserted after each separate statement.

If the other party disagrees with any or all of the statements of fact, he shall set forth each correction which he believes the evidence requires and shall give the same numbers to his statements of fact as appear in his opponent's brief. His statement of fact shall be set forth in accordance with the requirements above designated.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *.

SEC. 19.23 (a)-6. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. * * *

* * * * *

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. * * *



No. 12143

In the United States Court of Appeals
for the Ninth Circuit

WALTS, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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FILE

JUN 20 1950

PAUL P. STEINER

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 47-61) are unreported.

JURISDICTION

This petition for review (R. 69-77) involves federal declared value excess profits and excess profits taxes for the taxable year 1942. On October 27, 1944, the Commissioner of Internal Revenue mailed to taxpayer a notice of deficiency in the total amount of \$29,711.20. (R. 11-20.) Within 90 days thereafter and on January 23, 1945, the taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 5-20.) The decision of the Tax Court redetermining

the deficiency was entered April 10, 1947. (R. 66.) This case is brought to this Court by a petition for review filed July 7, 1947 (R. 69-77), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether the Tax Court properly entered its decision based upon findings of fact and conclusions of law by a judge of the Tax Court who did not conduct the hearing or trial of the case, and accordingly whether or not the Tax Court should have granted taxpayer's motion for a rehearing *de novo* under such circumstances.

2. Whether in recomputing taxpayer's deficiencies in declared value excess profits and excess profits taxes for the taxable year the Tax Court should have deducted taxpayer's postwar excess profits tax credit, provided by Sections 780 and 781 of the Internal Revenue Code.

3. Whether, in determining a reasonable allowance for salary expenses under Section 23 (a)(1) (A) of the Internal Revenue Code, the Tax Court was required to accept as conclusive evidence of the cost to taxpayer had other employees done the work done by the officers whose salaries are in question.

4. Whether the Tax Court's findings as to a reasonable allowance for salaries under Section 23 (a)(1)(A) of the Internal Revenue Code are clearly erroneous.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations may be found in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court are substantially as follows:

Taxpayer, Walts, Inc., known also by the name Aero Alloys, has its principal office and place of business in Los Angeles, California. (R. 47.)

Taxpayer's president, Walter J. Cunningham is a veteran of World War I. Prior to entering the service, he had had a high school education, spent two years at business college, and had one year at Williams College. When he was discharged, he worked one year as a claims adjuster. In 1920, he became associated with his father in the lumber business in Rochester, New York. From 1922 to 1925, he was secretary and treasurer of the company, receiving compensation of from \$12,000 to \$15,000 annually, approximately one-half in salary, the remainder in commissions and bonuses. The lumber company underwent reorganization under Section 77B of the Bankruptcy Act in 1932 and thereafter continued in business until dissolution in 1935. (R. 48.)

Cunningham then went to the West Coast, in October 1936, and became a salesman with a lumber company there doing much the same kind of work he had done in Rochester, receiving a salary of \$270 monthly. (R. 48.)

Subsequently, he met Walter E. Withers and J. Robert Muratta. Withers owned some foundry equipment. Cunningham looked the equipment over and suggested moving it to an industrial section and organizing a foundry corporation. Taxpayer was thereafter incorporated under the laws of California, April 24, 1940, with an authorized capital stock of \$25,000, divided into 2,500 shares at a par of \$10. (R. 48-49.)

Taxpayer's articles of incorporation were executed by Cunningham, Withers, and Muratta, who were named therein as its directors. Withers was elected

president; Muratta, vice-president; Cunningham, secretary-treasurer. Withers acquired 100 shares of stock by paying \$500 and transferring to the taxpayer foundry equipment worth \$600. Katharyn S. Cunningham, wife of Walter J., acquired 50 shares by paying \$500 borrowed from her father. Walter J. Cunningham did not invest in taxpayer's business and was not a stockholder at any time. (R. 49.)

Under date of February 26, 1941, taxpayer and the Aluminum Company of America (ALCOA) entered into two licensing agreements, wherein ALCOA licensed taxpayer to use its patented processes for the thermal treatment of casting of aluminum alloy compositions, in consideration of certain royalties. (R. 49.)

At a meeting of taxpayer's board of directors, March 31, 1941, Cunningham informed the board that Katharyn S. Cunningham's efforts had been responsible for procuring the licensing agreements, and that she had incurred obligations and expenses to the extent of \$1,140 in obtaining them. The board resolved that she be reimbursed. It also authorized the leasing or construction of an adequate plant and the purchase and installation of equipment to maintain the plant for the manufacture of aluminum alloy products. To obtain needed funds, the directors authorized the borrowing of \$8,500 from the wife of Elmer D. Morse, which was done, taxpayer giving its note for the loan. Thereafter a building was leased. (R. 49-50.)

At the meeting the board also authorized payment of salaries—\$200 per month each to Morse and Cunningham. It accepted Muratta's resignation as a director and vice-president and appointed Morse in his stead as a director. Withers also resigned as a director and president. Cunningham was named president, Morse, secretary and treasurer. (R. 50.)

At or about the time of the March, 1941 meeting,

Katharyn S. Cunningham and Morse became the owners of the 150 outstanding shares of taxpayer's stock. This ownership prevailed throughout the remainder of 1941 and during 1942. (R. 50.)

On January 5, 1942, the stockholders of taxpayer had a meeting and elected Walter J. Cunningham, Katharyn S. Cunningham, Dorothy M. Morse, and Elmer D. Morse to be directors. At a directors' meeting on the same day the board resolved that Cunningham and Morse each be paid at the rate of \$24,000 per annum for their services, effective as of January 1, 1942. Cunningham was elected president; Mrs. Cunningham, vice-president; Morse, secretary-treasurer; and Mrs. Morse, vice-president. (R. 50-51.)

At a meeting held April 10, 1942, the directors authorized the purchase and installation of a new heat treating furnace at a cost of approximately \$5,000 and the erection of an addition to taxpayer's plant, together with additional necessary equipment, to cost about \$3,000. (R. 51.)

On June 12, 1942, the directors authorized taxpayer's president and treasurer to erect an additional building on the north side of taxpayer's plant and to purchase additional equipment therefor. (R. 51.)

At a meeting held August 14, 1942, taxpayer's directors adopted a motion "that each director be paid the sum of \$25 for attendance at each meeting of the board". (R. 51.)

On August 28, 1942, the Aluminum Company of America wrote taxpayer that because of the direct and immediate relationship of the heat treatment of aluminum alloy castings to war production, the license agreement of February 26, 1941, was to be royalty-free from July 1, 1942, until the cessation of hostilities. (R. 51.)

At a meeting, August 28, 1942, the directors resolved that Cunningham and Morse each be paid at the rate of

\$36,000 per annum for their services, effective as of September 1, 1942. (R. 51-52.)

Between August 28, 1942, and December 30, 1942, inclusive, ten recorded directors' meetings were held, at each of which all four directors were present. Discussions dealt chiefly with reports on the increase in taxpayer's business, bank loans, construction of additions to taxpayer's plant, purchase of necessary additional equipment, the authorization thereof, and of other expenditures; also that arrangements had been made for a line of credit with the Bank of America, up to \$25,000. (R. 52.)

During 1942, taxpayer's business consisted entirely of manufacturing and sale of airplane parts as a subcontractor for aircraft manufacturers engaged in war work, the parts being of aluminum made with the heating processes covered by taxpayer's licensing agreements with ALCOA. (R. 52.)

In 1940, taxpayer's gross sales were \$1,227.38, and it sustained an operating loss for the year of \$1,123.58. No salaries were paid by taxpayer to any of its officers or directors in that year. Gross sales in 1941 amounted to \$39,996.19, and the Commissioner determined that taxpayer had an adjusted net taxable income of \$1,205.92. In 1941, taxpayer paid salaries to its officers of \$3,300, \$1,650 each to Cunningham and Morse, both of whom devoted their entire time to taxpayer's business and operations. During the calendar year 1942, taxpayer's gross sales amounted to \$434,363.44, and its net profit before payment of salaries to its officers amounted to \$85,828.39. Taxpayer paid officers' salaries that year of \$56,000, evenly divided between Cunningham and Morse, both of whom devoted their full time to the business and operations of taxpayer. In addition, each of the four directors was paid \$250 during 1942 for attendance and services at directors' meet-

ings, at the rate of \$25 per director for each of the ten meetings held during the year. (R. 52-53.)

No dividends were paid by taxpayer at any time between April 24, 1941 and December 31, 1942, inclusive. The gross sales, as shown by taxpayer's books, reflect the following monthly balances between August 31, 1941, and December 31, 1943 (R. 53) :

Aug. 31, 1941	\$ 7,208.87	Nov. 30, 1942	\$369,684.11
Sept. 30, 1941	10,357.09	Dec. 31, 1942	434,363.44
Nov. 30, 1941	26,789.91		
Dec. 31, 1941	39,996.19	Jan. 31, 1943	\$ 68,469.17
		Feb. 28, 1943	151,118.93
Jan. 31, 1942	\$ 11,982.38	Mar. 31, 1943	246,500.53
Feb. 28, 1942	25,321.67	April 30, 1943	337,799.36
Mar. 31, 1942	42,455.69	May 30, 1943	399,247.60
April 30, 1942	65,515.58	June 30, 1943	474,109.72
May 31, 1942	91,019.92	July 31, 1943	551,789.76
June 30, 1942	126,858.37	Aug. 31, 1943	617,334.03
July 31, 1942	170,755.49	Sept. 30, 1943	685,084.75
Aug. 31, 1942	215,347.22	Oct. 30, 1943	776,982.08
Sept. 30, 1942	263,711.51	Nov. 30, 1943	873,646.35
Oct. 31, 1942	311,958.67	Dec. 31, 1943	964,862.25

In determining the deficiencies, the Commissioner disallowed \$36,000 of the total amount of \$56,000 paid as salaries to Cunningham and Morse in the taxable year 1942. The Commissioner also disallowed directors' fees totalling \$1,000, paid to the four directors for attendance at ten meetings, at the rate of \$25 a meeting. (R. 54.)

During 1942 both Cunningham and Morse devoted from 12 to 14 hours each day to their duties as president and secretary-treasurer. Cunningham performed a variety of duties that year, including those of general and production manager, sales promotion, metallurgist, shipping clerk and inspector of castings. Morse, who had operated several sporting goods stores prior to his association with taxpayer, handled the financial end of the business, office detail, and matters pertaining to the scheduling of parts out of the foundry. Morse severed his connections with taxpayer in 1943. (R. 54.)

The profit and loss account appearing on taxpayer's books for 1941 and 1942 reflects the following (R. 54) :

	1941	1942
Sales	\$39,996.19	\$434,363.44
Cost of goods sold	31,261.93	329,163.97
Gross profit	8,734.26	105,199.47
Compensation of officers	3,300.00	56,000.00
Other expenses	3,950.04	19,371.08
Net profit (before taxes)	1,484.22	29,828.39

The Tax Court found that a reasonable allowance for the salaries for services rendered by Morse and Cunningham in 1942 was \$10,000 each per annum. The court also found that a reasonable allowance for directors' fees for services rendered by the four directors of taxpayer at the ten meetings they attended between August 28, 1942, and December 31, 1942, inclusive, was \$25 per meeting, a total of \$1,000. (R. 54-55.)

Taxpayer appeals from the findings of the Tax Court, having filed its petition for review July 7, 1947. (R. 3.)

SUMMARY OF ARGUMENT

1. Congress contemplated in creating the Tax Court that the personnel of a division to which a case is assigned to submit findings in a report to the full court might, for various reasons, have to be changed during the course of a hearing, determination, or final report to the Tax Court. Accordingly, it vested the presiding judge with authority to make substitutions as to judges assigned to the various divisions of the court. A formal order is not required in such substitutions. In view of Tax Court procedure in the promulgation of its decisions, it is not material whether or not the judge who hears the evidence makes the report to the court which may or may not become the basis for the court's decision, so long as the report is based on the evidence. In providing for decisions based upon the report of one judge, and in providing for the appointment of commissioners, the statute contemplates that the judge who

makes a report of findings to the court may not be the same one who heard the case. The procedure followed herein was authorized by the controlling statutes. Taxpayer was not denied due process of law by the procedure followed. It received a hearing in a substantial sense, which is all that is required. Furthermore, taxpayer makes no valid showing of prejudice.

The Tax Court could not allow taxpayer a ten percent postwar credit in computing the deficiency, since it did not have jurisdiction over the credit.

The fact that taxpayer's officers did work that might have been done by many other employees does not necessarily support the reasonability of compensation paid them. It is clear that one of the officers could not do the full time work of eight men and therefore merit the full wages payable to all eight.

What constitutes a reasonable allowance for salary expenses is a matter of fact. The Tax Court properly took many factors into account in determining what would constitute a reasonable salary under the circumstances, and determined that the evidence presented a studied plan of distributing profits in the guise of salary. Ample evidence supports this conclusion. Neither officer had special qualifications; war conditions contributed to abnormally high profits, not the services of the officers; services were not the guiding factor in determining salaries; no dividends were paid in the taxable year; salaries were paid in direct proportion to family stockholdings in the corporation. The Tax Court's findings are supported by ample evidence and should not be disturbed.

I

Taxpayer Was Not Denied Due Process of Law Because the Judge Who Took Testimony Did Not Write the Findings of Fact and Opinion

Taxpayer first raises the point that due process of law required a decision by Judge Black, who heard the case, or in the alternative that a trial *de novo* should have been held. It also contends that Sections 1116, 1117(b), and 1118(a) of the Internal Revenue Code (Appendix, *infra*) were violated. (Br. 10-21.) There is no merit to any of these contentions.

The Tax Court exists under, and its powers and duties are defined by Sections 1100-1146 of the Internal Revenue Code, as amended by Section 504 of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U.S.C. 1946 ed., Secs. 1100-1146). It is composed of sixteen judges (Section 1102(a)), who designate one of their number to act as presiding judge (Section 1103(b) (Appendix, *infra*)). The presiding judge has authority under Section 1103(c) (Appendix, *infra*) to divide the Tax Court into divisions of one or more judges, to assign the judges thereto, and in the case of a vacancy, absence, or inability of a judge to serve on a division to assign another or other judges to the division. Section 1118(a) provides that the division to which a proceeding is assigned shall hear, determine, and make a report consisting of findings of fact and opinion (Section 1117(b)) of its final determination. The report of the division becomes the report of the Tax Court within 30 days after it is made unless within such period the presiding judge directs that the report shall be reviewed by the whole Tax Court Section 1118(b).

It is thus obvious that Congress contemplated that a change in the personnel of a division might become necessary for various reasons during the course of the

hearing, determination, or final report to the Tax Court, of a proceeding assigned to the division and that it vested the presiding judge with the authority to make a substitution of judges, in the division or to transfer the proceeding to another division as an inter-office matter. There is no requirement for a formal order transferring the proceeding from one judge to another or for notice to the taxpayer of the transfer. The record in this case does not disclose the administrative reason for the transfer of this case, but whatever the reason the presiding judge did not exceed his authority in transferring the present case from Judge Black to Judge Harlan without notice to the taxpayer.

It is thus obvious that under the statutory provisions the taxpayer has no cause for complaint. This is particularly true, since the report of the division, consisting of suggested findings of fact and opinion is made to the whole Tax Court, rather than to the parties. Only after it has been examined by the presiding judge, and informally by the other judges during a thirty-day period,¹ does it become the report of the Tax Court. Where unreviewed the division's report is thus accepted by the whole court, and where reviewed, the division's report is rejected and is not even a part of the record. Section 1118(b). In view of this procedure it is manifestly immaterial whether or not the judge who took the evidence makes the report to the Tax Court, so long as the report is based on the evidence which is stenographically reported insofar as it consists of testimony (Section 1116), and on the argument, as it was here. Indeed, as has been shown, the statute contemplates that the judge who makes the report may not be the same judge who heard the case. This is shown,

¹ We are informed that the report of a division is circulated among all the judges each of whom has an opportunity to submit any objections thereto to the presiding judge, or to request a review by the whole court.

further, by the fact that where the whole Tax Court reviews, fifteen of its judges have not heard the evidence although they make findings of fact and render an opinion thereon. This procedure is authorized by statute and is well established. Also, the Code even authorizes the presiding judge to appoint an attorney on the court's legal staff to act as commissioner in a particular case. Section 1114(b) (Appendix, *infra*). His role, like commissioners in the Court of Claims, would undoubtedly be to take the evidence and render suggested findings thereon to the Tax Court Section 1114(b).

Contrary to taxpayer's argument, Sections 1116, 1117(b), and 1118(a) of the Code, were complied with. The hearing presided over by Judge Black at which the evidence was taken was a public one, and the testimony was stenographically reported. The report of Judge Harlan, the division to whom the case was assigned in full accord with the statutory procedure, to the whole Tax Court contained findings of fact and opinion and this report was adopted by the whole Tax Court as its report on which decision was entered. In view of other provisions of the Code already discussed, Section 1118 (a) obviously does not mean that a case may not be re-assigned to another division for a report after one division has heard the evidence.

Since the procedure followed in this case was authorized by the controlling statutes, it remains to consider only whether this procedure withheld due process of law from the taxpayer. *Morgan v. United States*, 298 U. S. 468, the only case relied on by the taxpayer, shows clearly that due process of law was accorded the taxpayer. The complaint therein was that the Secretary of Agriculture made a rate order without having heard or read any of the evidence and without having heard the

oral arguments or read the briefs. In this connection the Court said in the *Morgan* case that (pp. 481-482)—

the weight ascribed by the law to the findings—their conclusiveness when made within the sphere of the authority conferred—rests upon the assumption that the officer who makes the findings has addressed himself to the evidence and upon that evidence has conscientiously reached the conclusions which he deems it to justify. That duty cannot be performed by one who has not considered evidence or argument. It is not an impersonal obligation. It is a duty akin to that of a judge. The one who decides must hear.

This necessary rule does not preclude practicable administrative procedure in obtaining the aid of assistants in the department. Assistants may prosecute inquiries. *Evidence may be taken by an examiner.* Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical. But there must be a hearing in a substantial sense. And to give the substance of a hearing, which is for the purpose of making determinations upon evidence, the officer who makes the determinations must consider and appraise the evidence which justifies them. * * * (Emphasis supplied.)

In this case there was a hearing “in a substantial sense.” Clearly the deciding judge herein considered the reported evidence in making his findings of fact, even though he did not preside at the hearing where the evidence was received. And there is no allegation that he did not consider the briefs, this constituting consideration of argument, which as the Supreme Court pointed out might be oral or written. The taxpayer was not denied due process of law, as explained in the *Morgan* case.

The problem of one judge of the Tax Court hearing

a case, another writing the opinion has occurred before. Taxpayer perhaps overlooks the point that all Tax Court opinions are the result of just such a delegation as the Supreme Court condoned in the *Morgan* case. Decisions are not made by the judges who hear cases or make findings therein. Their findings are embodied in a report to the Tax Court, which may or may not then become the report of the Tax Court, under Section 1118 (b) of the Internal Revenue Code. In *Davidson v. Commissioner*, 91 F. 2d 516 (C.A. 5th), evidence was taken before two members of the Board of Tax Appeals. One of them later died; the other resigned. A third Board member made findings of fact and rendered an opinion which was reviewed and adopted by the Board. The court approved this procedure, stating (p. 518):

It would unnecessarily, and to no good purpose, complicate and delay the disposition of business by the Board if proceedings before one who had ceased to be a member had to be abandoned and held for naught. It was within the sound discretion of the Board to enter judgment on the findings of facts and opinion of Board member Murdock [the third member noted above]. We find no abuse of discretion in this respect.

Accord: *Garden City Feeder Co. v. Commissioner*, 75 F. 2d 804 (C.A. 8th). Compare *Askania Werke, A. G. v. Helvering*, 96 F. 2d 717 (C.A. D.C.). It seems clear that the Tax Court acted within its discretion in entering a decision on Judge Harlan's report, and in denying taxpayer's "Motion for Rehearing *de Novo*." (R. 61-65.)

Both in its brief and in its motion for rehearing below, taxpayer has made the allegation that it was prejudiced by the reassignment of the cause for findings of fact and opinion. We do not consider this allegation alone a sufficient showing of prejudicial error. The

fact that the Tax Court sustained the Commissioner's determination of deficiency is not in itself prejudicial error. In the motion for rehearing, taxpayer also alleged prejudice in the court's failure to consider certain evidence. This is discussed under point III, *infra*.

II

The Tax Court Properly Denied Taxpayer's Motion to Correct Its Decision in Respect to the Ten Percent Postwar Credit

Taxpayer contends (Br. 22 *et seq.*) that the Tax Court erred in failing to allow a ten percent postwar credit under Sections 780 and 781 of the Code (Appendix, *infra*) against the Commissioner's recomputation of deficiency. In support thereof, taxpayer relies on language in *Altschul's, Inc. v. Commissioner*, 9 T. C. 697, acquiescence, 1948-1 Cum. Bull. 1. That case is, however, not in point here. The question there was whether the postwar credit was sufficiently ascertainable at the end of the tax year so as to be taken into account in determining the taxpayer's accumulated earnings and profits at that time and the Tax Court's discussion of Sections 780 and 781 was related to this problem only. The case of *California Vegetable Concentrates, Inc. v. Commissioner*, 10 T. C. 1158, acquiescence, 1948-2 Cum. Bull. 1, is in point, and therein the full Tax Court, in a reviewed opinion held (pp. 1171-1172) that it did not have jurisdiction over the postwar excess profits tax credit, stating that it had no place in the computation of a deficiency, and that instead it is a credit to the tax account of a taxpayer for which bonds or cash may be issued. That this is a proper conclusion is clear from a reading of the provisions of Sections 780 and 781 of the Code. The allowance of the credit is under the jurisdiction of the Secretary of the Treasury only.

III

It Was Not Error to Minimize Evidence That Taxpayer's Officers Did Work Which Would Otherwise Have Acquired the Services of Many Additional Employees *Re*

Taxpayer argues (Br. 25 *et seq.*) that the Tax Court erred in failing to find, in accordance with undisputed evidence, that taxpayer would have been obliged to pay more than \$42,000 to others, had it hired others to perform the services performed by Cunningham. Also (Br. 30), taxpayer in a note seeks a concession of correctness of its statements from the Commissioner. If taxpayer wishes the Court to consider the briefs in the Tax Court, we have no objection to augmentation of the record to include them.

Taxpayer exhibits some irritation that the Tax Court found that "an unimpressive attempt was made to prove that petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham, * * *." (R. 60.) We also consider the attempted proof unimpressive and not entitled to any weight.

Taxpayer sought to prove that Cunningham did the work of a metallurgist, a shipping clerk, a general manager, an inspector of castings, a superintendent of production, and a salesman, the probable salaries of which for full-time work are offered, as well as pattern-maker and invoice clerk. This is an impressive role of duties, the work of eight men. Working full time they would have done work which would constitute a memorable achievement for one man. We do not seek to minimize evidence that Cunningham worked many hours each day. We simply question whether he did the compensable work of eight men full time each day. We consider the task impossible, and argument based upon such evidence absurd. Obviously the Tax Court felt the same way. Where evidence, even though uncon-

tradicted is contrary to human experience, the Tax Court is of course not required to accept it at face value. The prejudicial error of the Tax Court is not only not self-evident on this score, it is self-evident that the Tax Court would have committed prejudicial error had it given weight to taxpayer's evidence as to the many men supposedly displaced by Cunningham.

IV

The Tax Court Properly Concluded That \$10,000 Was a Reasonable Compensation for Morse and Cunningham

Lastly, on the merits of the case, taxpayer contends that the Tax Court erred in finding that payments to Cunningham and Morse in the taxable year were excessive of reasonable compensation. Section 23(a) (1)(A) of the Internal Revenue Code (Appendix, *infra*) provides for the deduction of ordinary and necessary business expenses, including "a reasonable allowance for salaries or other compensation for personal services actually rendered." The applicable Treasury Regulations (Treasury Regulations 111, Section 29.23 (a)-6 (Appendix, *infra*)), similarly provide.

What constitutes a reasonable allowance for compensation payments is a factual question for the Tax Court. *Kennedy Name Plate Co. v. Commissioner*, 170 F. 2d 196 (C.A. 9th). Unless the Tax Court's decision then is clearly erroneous, its determination should not be disturbed on review.

Many factors may be taken into account in attempting to ascertain in given circumstances what is a reasonable salary for the services rendered. See *Commercial Iron Works v. Commissioner*, 166 F. 2d 221 (C.A. 5th); 4 Mertens, *Law of Federal Income Taxation*, Section 25.51, *et seq.* In the case at bar, the Tax Court noted the following in determining whether amounts paid Morse and Cunningham were reasonable; that neither had any

special qualifications for the business ; that the principal factor in the success of the business was not their efforts but the licensing agreement with ALCOA and the war-time demand for their products ; that the services of Morse and Cunningham were not the "guiding factor" which influenced the setting of the salaries ; that no dividends were paid in the period in question ; that the Cunningham and Morse family holdings were equal, and that equal compensation was paid through the two officers to each family, such payment being consistent with payment for services. The Tax Court finally concluded that the taxpayer had not borne the burden of showing that Morse and Cunningham could reasonably be paid more than \$10,000 each per annum for the services which they rendered. We contend that the factors considered by the Tax Court substantiate its decision.

The Tax Court properly took into consideration whether Cunningham and Morse had any special qualifications. *Patton v. Commissioner*, decided April 30, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,119), affirmed, 168 F. 2d 28 (C.A. 6th) ; *N. A. Woodworth Co. v. Commissioner*, decided April 20, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,137).

In the *Woodworth* case, for example, the court found a large salary reasonable where the spectacular growth of the corporation was due largely to the special training and abilities of the employee. Neither Morse nor Cunningham had any particular qualifications for the work they did. Both had been in business before, but that is about the most that can be said, since their former business experience was entirely unrelated to taxpayer's business. Their previous work had not particularly qualified either of them to operate a foundry.

Although both Morse and Cunningham put in long hours, the principal factor in the growth of the business

was the licensing agreement with ALCOA, coupled of course with the boom in demand for taxpayer's products as a result of the war. Mrs. Cunningham was the procuring cause of the agreement, and was reimbursed for her expenses. If further compensation for the procurement of the agreements is due, it is due her, not Cunningham or Morse. Without the licensing agreement, the growth of the business would most probably have been slower. It is well settled that the Tax Court may take into account the abnormal growth of business because of war conditions. *Locke Machine Co. v. Commissioner*, decided March 7, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,067), affirmed, 168 F. 2d 21 (C.A. 6th), certiorari denied, 335 U.S. 861; *Wood Roadmixer Co. v. Commissioner*, 8 T.C. 247; *Hewitt Rubber Co. v. Commissioner*, decided November 28, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,317); *Cooked Foods, Inc. v. Commissioner*, decided July 25, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,223). The mere use of a product in connection with the prosecution of the war is not ground for disallowing compensation for procuring war orders, where extraordinary or special effort is required or where expansion is due almost entirely to the industry and ability of the officers of the business whose salaries are sought to be deducted. *Dixie Frosted Foods, Inc. v. Commissioner*, decided May 29, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,145). Accord: *N. A. Woodworth Co. v. Commissioner*, *supra*. But such facts are not present here. It is clear that the tremendous progressive increases in taxpayer's sales reflect war demand for airplane parts which taxpayer fabricated. Its sole business in 1942 was making airplane parts as a sub-contractor for aircraft plants engaged in war production. No figures appear for postwar years, but it is a fair surmise that taxpayer's

gross sales reflected the drop in aircraft demand in those years. And as the cases indicate, the Tax Court—quite properly so, in view of the Government's demands for revenue in the war years—as well as the Commissioner has been reluctant to credit deductions for large salary increases where increased profits so clearly reflect war production activity.

It was proper for the Tax Court to take into account the fact that services were not the guiding factor in determining the amounts of salary Cunningham and Morse merited. Necessarily, to protect the revenue against spurious deductions, distributions under the guise of salary that are not salary cannot be allowed to be deducted as salary. Obviously, it is reasonable to reward long service by raises in salary, but hardly is it so when the increase is disproportionate. The moral obligations of the corporation may move it in its actions, but that obligation is insufficient to come within the grace of the deduction provided for reasonable compensation paid for services rendered. The testimony is varying on the extent to which services entered into a determination of amount. Cunningham stated that past performances and experience were the guiding factor, that the decision to award \$24,000 per annum did not take into account what might ensue after that date (R. 164); he also stated that work in forming the corporation was taken into account (R. 165). His wife pointed out that the increase was authorized because her husband was accustomed to earning that much in the past. (R. 216.) The increase to \$36,000 per annum, voted on the day taxpayer was notified that its license would be royalty free, is more transparent. Cunningham and his wife both testified that increased sales had a bearing on the increase. (R. 166,214.) There is no evidence showing a 50 percent increase in services rendered between January, 1942, and August 28, 1942.

It is significant that although 1942 was a year of unprecedented prosperity for taxpayer, no dividends were paid on its stock. Large increases in compensation to the officers of a corporation come in for close scrutiny where no dividends are paid. *Clinton Co. v. Commissioner*, decided May 17, 1945 (1945 P-H T. C. Memorandum Decisions, ¶ 45,175), affirmed, 159 F. 2d 102 (C.A. 7th). The Commissioner and the courts must maintain a sharp lookout for distribution of profits under the guise of salaries. Accord: *Twin City Tile & M. Co. v. Commissioner*, 32 F. 2d 229 (C.A. 8th), affirming 6 B. T. A. 1238. As the Tax Court pointed out below, the salaries paid Cunningham and Morse were in direct proportion to the stockholdings in taxpayer of the Morse and Cunningham families, holdings of equal amount. As it further stated (R. 60) "The equality of compensation paid to these two officers seems to us to be inconsistent with an intention to compensate them on the basis of the value of the services rendered * * *". As has been the result in other cases, the Tax Court properly looked through the pretense of salary payment aligned to stockholdings.² *Transportation Service Associates, Inc. v. Commissioner*, decided February 11, 1944 (1944 P-H T. C. Memorandum Decisions, ¶ 44,036), affirmed, 149 F. 2d 354 (C.A. 3d); *Crescent Bed Co. v. Commissioner*, 133 F. 2d 424 (C.A. 5th). The courts

² The Tax Court was not precluded from inferring that the so-called compensation payments to Morse and Cunningham were in reality in part a distribution of profits in accord with the stockholdings of the two families by the fact that the Commissioner did not expressly so determine in his deficiency letter. *Heckett v. Commissioner*, 8 T. C. 841, 844, cited by taxpayer (Br. 37), involved an entirely different situation. The Commissioner did determine that \$28,000 was excessive compensation and that \$10,000 only was a reasonable allowance for the services rendered by each officer and any considerations relevant to that issue are properly considered. As the above discussion shows, the courts have repeatedly appraised the so-called salary payments in the light of whether a distribution of profits might be included.

have been reluctant to question the motives of boards of directors in awarding salaries. The action of a board is presumptively proper. But this presumption depends upon the relationship between the employees and the board; where the board is not independent or where there is a closely held corporation, the reluctance disappears. *L. E. Pinkham Med. Co. v. Commissioner*, 128 F. 2d 986 (C.A. 1st), certiorari denied, 317 U. S. 675; *Glenshaw Glass Co. v. Commissioner*, decided October 15, 1946 (1946 P-H T. C. Memorandum Decisions, ¶ 46,245), affirmed, October 21, 1947 (C.A. 3d), certiorari denied, 333 U. S. 842.

In his brief (p. 38), taxpayer relies on *Coastal Stevedoring Corp. v. Commissioner*, decided May 12, 1944 (1944 P-H T. C. Memorandum Decisions, ¶ 44,158), as being substantially parallel to the case at bar. It has points of similarity, but may be distinguished on the basis that therein there was a distribution of dividends; there is no evidence of such a distribution herein. The Tax Court also emphasized in the *Coastal Stevedoring* case that the duties of the officers compensated had increased commensurate with their salary increases. Such a conclusion would not, we submit, be justified herein.

It is clear from the foregoing that taxpayer has not sustained its burden of showing that the determinations of the Commissioner and of the Tax Court were wrong. There is ample authority for the Tax Court to have taken into account the elements in reasonability that it did, and there is ample evidence to sustain its findings. It may well be said that no one of the facts herein is sufficient to indicate that the salaries taxpayer sought to deduct were not reasonable with the Code provision providing a deduction, but an examination of all the facts makes it clear beyond question that what was attempted here was a distribution of profits to the stock-

holders in the guise of salary payments. Against just such a manipulation the courts have protested. In the circumstances here we believe that the only conclusion possible was the one reached by the Tax Court, that the salaries paid were unreasonable for the services rendered and that the Commissioner's determination of a reasonable salary for each officer should be sustained. Even if any other conclusion were possible, it cannot be said that the conclusion of the Tax Court was clearly erroneous, and therefore it is conclusive upon the Court herein.

CONCLUSION

In view of the foregoing, it is respectfully submitted that the Tax Court committed no error of law and that the Tax Court's finding as to reasonability is not only not clearly erroneous but is the only finding that could have been made in the circumstances.

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JUNE, 1949.

APPENDIX

Internal Revenue Code:

SEC. 23 [as amended by Sec. 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses*.—

(1) *Trade or Business Expenses*.—

(A) *In General*.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 780 [as added by Sec. 250 of the Revenue Act of 1942, *supra*, and amended by Sec. 3 of the Tax Adjustment Act of 1945, c. 340, 59 Stat. 517].
POST-WAR REFUND OF EXCESS PROFITS TAX.

(a) *In General*.—The Secretary of the Treasury is authorized and directed to establish a credit to the account of each taxpayer subject to the tax imposed under this sub-chapter, for each taxable year ending after December 31, 1941 (except in the case of a taxable year beginning in 1941 and ending before July 1, 1942), and not beginning after December 31, 1943, of an amount equal to 10

per centum of the tax imposed under this subchapter for each such taxable year. For the purposes of this Part, in the case of a taxpayer whose tax is determined under section 710 (a) (3), the term "tax imposed under this subchapter" means the excess of the tax imposed by such section 710 (a) (3) over the tax that would be imposed if such section 710(a) (3) were not applicable.

(b) *Application of Credit to Purchase of Bonds.*—Within three months after the payment of the amount of the excess profits tax shown on the return for a taxable year to which subsection (a) applies, if the payment is made before July 1, 1945, there shall be issued to and in the name of the taxpayer bonds of the United States in an aggregate amount equal to 10 per centum of the tax paid in respect of which a credit is provided under subsection (a), and the credit established under subsection (a) for such taxable year is hereby made available for the purchase of such bonds.

* * * * *

(26 U.S.C. 1946 ed., Sec. 780.)

SEC. 781 [as added by Sec. 250 of the Revenue Act of 1942, *supra*, and as amended by Sec. 3 of the Tax Adjustment Act of 1945, *supra*]. SPECIAL RULES FOR APPLICATION OF SECTION 780.

(a) *Effect of Deficiencies.*—If a deficiency in respect of the excess profits tax for any taxable year for which a credit is provided in section 780 (a) is paid by the taxpayer before July 1, 1945, an amount of such credit equal to 10 per centum of the excess of the tax imposed by this subchapter on the basis of which the deficiency was determined, over the tax imposed by this subchapter as previously computed and paid shall be available, as provided in section 780 (b), for the purchase of bonds as provided under such section, and there shall be issued to the taxpayer bonds under such section in an amount equal to such excess and with the same maturity as in the case of bonds issued

with respect to the taxable year with respect to which the deficiency is determined.

* * * * *

(c) *Tax Payments After Cut-Off Date.*—In the case of a payment of the tax imposed by this subchapter shown on the return for any taxable year for which a credit is provided in section 780 (a), or the payment of a deficiency in respect of such tax for any such taxable year, on or after July 1, 1945, the amount of the credit under section 780 (a) for such taxable year attributable to such payment shall be paid the taxpayer in cash. No interest for the period after December 31, 1945, shall be assessed or collected on that portion of the tax or deficiency so paid equal to the credit under section 780 (a) attributable to such payment. If after January 1, 1946, there is any credit under section 780 (a) remaining in favor of the taxpayer attributable to any taxable year for which a credit is provided in section 780 (a), such remainder shall be paid to the taxpayer in cash. No amount of any payment made under this subsection to a taxpayer shall be included in gross income.

* * * * *

(26 U.S.C. 1946 ed., Sec. 781.)

SEC. 1103. ORGANIZATION.

* * * * *

(b) *Designation of Chairman.*—The Board shall at least biennially designate a member to act as chairman.

(c) *Divisions.*—The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of

members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto.

(d) *Quorum*.—A majority of the members of the Board or of any division thereof shall constitute a quorum for the transaction of the business of the Board or of the division, respectively. A vacancy in the Board or in any division thereof shall not impair the powers nor affect the duties of the Board or division nor of the remaining members of the Board or division, respectively.

(26 U.S.C. 1946 ed., Sec. 1103.)

SEC. 1114 [as amended by Sec. 503 of the Revenue Act of 1943, c. 63, 58 Stat. 21]. ADMINISTRATION OF OATHS AND PROCUREMENT OF TESTIMONY.

* * * * *

(b) *Commissioners*.—The Presiding Judge may from time to time by written order designate an attorney from the legal staff of the court to act as a commissioner in a particular case. The commissioner so designated shall proceed under such rules and regulations as may be promulgated by the court. The commissioner shall receive the same travel and subsistence allowances now or hereafter provided by law for commissioners of the Court of Claims.

(26 U.S.C. 1946 ed., Sec. 1114.)

SEC. 1116. HEARINGS.

Notice and opportunity to be heard upon any proceeding instituted before the Board shall be given to the taxpayer and the Commissioner. If an opportunity to be heard upon the proceeding is given before a division of the Board, neither the taxpayer nor the Commissioner shall be entitled to notice and opportunity to be heard before the Board upon review, except upon a specific

order of the chairman. Hearings before the Board and its divisions shall be open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. The Board is authorized to contract (by renewal of contract or otherwise) for the reporting of such hearings, and in such contract to fix the terms and conditions under which transcripts will be supplied by the contractor to the Board and to other persons and agencies.

(26 U.S.C. 1946 ed., Sec. 1116.)

SEC. 1117. REPORTS AND DECISIONS.

(a) *Requirement.*—A report upon any proceeding instituted before the Board and a decision thereon shall be made as quickly as practicable. The decision shall be made by a member in accordance with the report of the Board, and such decision so made shall, when entered, be the decision of the Board.

(b) *Inclusion of Findings of Fact or Opinions in Report.*—It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions.

* * * * *

(26 U.S.C. 1946 ed., Sec. 1117.)

SEC. 1118. PROVISIONS OF SPECIAL APPLICATION TO DIVISIONS.

(a) *Hearings, Determinations, and Reports.*—A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

(b) *Effect of Action by a Division.*—The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

(26 U.S.C. 1946 ed., Sec. 1118.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(a)-6. *Compensation for Personal Services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (a) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the exces-

sive payments are a distribution of earnings upon the stock. (b) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

No. 12144

United States
Court of Appeals
for the Ninth Circuit

HOFFMAN RADIO CORPORATION,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

In Two Volumes

VOLUME I.

(Pages 1 to 288, inclusive)

Petition to Review a Decision of The Tax Court
of the United States

FILED

MAR 28 1949

PAUL P. O'BRIEN,
CLERK

No. 12144

United States
Court of Appeals
for the Ninth Circuit

HOFFMAN RADIO CORPORATION,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

CLAUDE I. PARKER, Esq.,
JOHN B. MILLIKEN, Esq.,
RALPH KOHLMEIER, Esq.,
HARRISON HARKINS, Esq.,
L. A. LUCE, Esq.

For Respondent:

EARL C. CROUTER, Esq.

Docket No. 11683

HOFFMAN RADIO CORPORATION (Formerly
Mission Bell Radio Mfg. Co., Inc.),

Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1946

July 31—Petition received and filed. Taxpayer notified. Fee paid.

July 31—Copy of petition served on General Counsel.

Sept. 10—Answer filed by General Counsel.

Sept. 10—Request for hearing in Los Angeles, Calif. filed by General Counsel.

Sept. 16—Notice issued placing proceeding on Los Angeles, Calif. calendar. Service of answer and request made.

1947

Sept. 30—Hearing set Dec. 1, 1947 at Los Angeles, Calif.

Dec. 11, 12—Hearing had before Judge Disney on merits. Stipulation of facts filed. Briefs due 2/2/48—replies 3/1/48.

Dec. 30—Transcript of hearing of 12/11/47 filed.

Dec. 30—Transcript of hearing of 12/12/47 filed.

1948

Jan. 28—Brief filed by General Counsel.

Jan. 30—Brief filed by taxpayer—copy served.

Feb. 13—Entry of appearance of Harrison Harkins as counsel filed.

Feb. 25—Reply brief filed by taxpayer. 2/26/48 copy served.

Feb. 25—Reply brief filed by General Counsel.

June 29—Memorandum findings of fact and opinion rendered, Disney J. Decision will be entered under Rule 50. 6/30/48 copy served.

Aug. 25—Computation as to deficiency filed by General Counsel.

Aug. 30—Hearing set Sept. 22, 1948 on respondent's computation.

Sept. 20—Consent to settlement filed by taxpayer.

Sept. 22—Decision entered, Disney J. Div. 4.

Nov. 30—Petition for review by U. S. Court of Appeals for the Ninth Circuit filed by taxpayer.

Nov. 30—Proof of service filed by taxpayer.

Dec. 16—Statement of points and designation of contents of record filed by taxpayer with proof of service thereon.

1948

- Dec. 16—Motion for transmission of stipulation of facts together with exhibits 1 to 22 both inclusive, petitioner's exhibits 1 to 5 both inclusive and respondent exhibits A to G both inclusive, in their form filed by taxpayer. [1 *]
- Dec. 16—Motion that the exhibits which this Court orders to be transmitted in physical form be retained by the Clerk of The Tax Court until 15 days prior to argument and then upon request of either party be transmitted to the Clerk of the U. S. Court of Appeals for the Ninth Circuit, filed by General Counsel.
- Dec. 29—Stipulation that the entire record on appeal including all exhibits be printed and further stipulated that respondent's motion be denied filed.
- Dec. 29—Certified copy of an order from the Ninth Circuit extending the time to February 8, 1949 to prepare and transmit record filed.
- Dec. 29—Respondent's motion of 12/16/48 ordered denied.
- Dec. 29—Order that petitioner's exhibits 1 to 5 inclusive, and respondent's exhibits A to G inclusive, be transmitted by The Tax Court to the Clerk of the U. S. Court of Appeals for the Ninth Circuit as physical documents entered. [2]

* Page numbering appearing at foot of page of original certified Transcript of Record.

The Tax Court of the United States

Docket No. 11683

HOFFMAN RADIO CORPORATION (Formerly
Mission Bell Radio Mfg. Co., Inc.), 3430 South
Hill Street, Los Angeles 7, California,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:PAK) dated May 9, 1946, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 3430 South Hill Street, Los Angeles 7, California. The return for the year here involved was filed with the Collector for the Sixth District of California. [3]

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to petitioner on May 9, 1946.

3. The taxes in controversy are declared value excess-profits tax, income tax, and excess profits tax for the calendar year 1943 in the amount of \$55,945.35.

4. The determination of tax set forth is said notice of deficiency is based upon the following errors:

(a) The respondent erred in determining deficiencies against petitioner for the calendar year 1943 with respect to declared value excess-profits tax, income tax, and excess profits tax in the respective amounts of \$1,334.34, \$3,279.24, and \$51,331.77.

(b) The respondent erred in disallowing a portion of the salaries and other compensation paid for the calendar year 1943 to the officers of petitioner for personal services actually rendered.

(c) The respondent erred in that he disallowed as a deduction, representing salary and other compensation paid by petitioner, in computing the net taxable income of petitioner for the calendar year 1943 the sum of \$48,784.28.

5. The facts upon which petitioner relies as the [4] basis of this proceeding are as follows:

(a) Petitioner, Hoffman Radio Corporation, represents a change in name only during the year 1943 of Mission Bell Radio Mfg. Co., Inc. Petitioner is a California corporation, incorporated on June 20, 1932, and is engaged now and was engaged during the year 1943 in the radio and electronic manufacturing business. During the year 1941 Mr. H. L. Hoffman became interested in the affairs of Mission Bell Radio Mfg. Co., Inc.; and upon investigation reached the conclusion that the corporation should, with able management and changed business policies, operate and conduct a profitable business. He and his associates worked out a deal whereby they might acquire the stock of the corporation. The corporation on December 4, 1941

entered into an employment contract with Mr. H. L. Hoffman whereby he would become president and general manager of the corporation, and agreed to pay him a fixed salary for his services and in addition thereto an amount equal to 3% of all of the gross sales of the corporation.

The corporation also authorized Mr. H. L. Hoffman to secure the services of a competent and well recognized radio engineer. Mr. Hoffman canvassed the entire [5] field and reached the conclusion after investigation that Mr. W. S. Harmon was a person who possessed such qualifications and who would render the highly specialized technical service which would be required for a corporation manufacturing radios and electronic equipment. The petitioner upon the recommendation of Mr. H. L. Hoffman entered into an employment contract with Mr. W. S. Harmon, agreeing to pay Mr. Harmon a weekly salary plus an additional compensation measured by 1% of the gross sales of the corporation.

During the calendar year 1943 Mr. H. L. Hoffman rendered his undivided time and attention to the affairs of petitioner and, as a result of the services rendered to petitioner, caused its business to be highly successful and to gain the prestige as one of the leading radio and electronic manufacturing corporations of America. Mr. W. S. Harmon rendered like services to petitioner during the calendar year 1943.

The petitioner pursuant to and in conformity with the contracts entered into with Mr. H. L.

Hoffman and Mr. W. S. Harmon paid to its general manager, Mr. H. L. Hoffman, for the calendar year 1943 compensation in the sum of \$63,613.20, representing an amount on the account of salary in the amount of \$8,800.00 and [6] contingent compensation in the amount of \$54,813.20; and paid for the calendar year 1943 to Mr. W. S. Harmon the sum of \$22,171.08, representing an amount on account of salary in the sum of \$3,900.00 and contingent compensation in the amount of \$18,271.08. The respondent in the audit of the tax return of petitioner for the calendar year 1943 determined that \$25,000.00 represented a reasonable compensation of Mr. H. L. Hoffman and disallowed the compensation paid to Mr. Hoffman in the sum of \$38,613.20; and determined that a reasonable compensation for Mr. W. S. Harmon should be in the sum of \$12,000.00 and disallowed the compensation paid to Mr. Harmon in the amount of \$10,171.08.

The respondent erred in disallowing any portion of the sums paid for the calendar year 1943 to Mr. H. L. Hoffman and Mr. W. S. Harmon, and the personal services actually rendered by each of the two persons in question was reasonable compensation for the valuable services rendered by each of them to petitioner for the calendar year 1943.

Wherefore, the petitioner prays that this Court may hear this proceeding and determine that petitioner is not [7] liable for the deficiencies in declared value excess-profits tax, income tax, and

excess profits tax as proposed by the respondent for the calendar year 1943, and for such other and further relief as this Court may deem just and proper.

Respectfully submitted,

/s/ CLAUDE I. PARKER,

/s/ JOHN B. MILLIKEN,

/s/ RALPH KOHLMEIER,

Counsel for Petitioner.

Of Counsel:

/s/ L. A. LUCE.

[8]

State of California,
County of Los Angeles—ss.

R. A. Yarcho, being duly sworn, says that he is the secretary of the petitioner and that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

R. A. YARCHO.

Subscribed and sworn to before me this 25th day of July, 1946.

M. L. BOSS,

Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires Oct. 21, 1948. [9]

EXHIBIT A

TREASURY DEPARTMENT

Internal Revenue Service

417 South Hill Street

Los Angeles 13, California

Office of Internal Revenue Agent in Charge

Los Angeles Division

May 9, 1946

LA:IT:90D:PAK

Hoffman Radio Corporation

(Formerly Mission Bell Radio Mfg. Co., Inc.)

3430 South Hill Street

Los Angeles 7, California

Gentlemen:

You are advised that the determination of your declared value excess-profits tax liability for the taxable years ended December 31, 1942 and 1943, discloses an overassessment of \$10.00 for the taxable year ended December 31, 1942, and a deficiency of \$1,334.34 for the taxable year ended December 31, 1943, and that the determination of your income tax liability for the taxable years mentioned discloses an overassessment of \$38.88 for the taxable year ended December 31, 1942, and a deficiency of \$3,279.24 for the taxable year ended December 31, 1943, and that the determination of your excess profits tax liability for the taxable year ended December 31, 1943, discloses a deficiency of \$51,331.77, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,

By GEORGE D. MARTIN,
Internal Revenue Agent in
Charge.

Enclosures: Statement, Form of Waiver, Forms
843. [10]

Statement

Tax Liability for the Taxable Years Ended
December 31, 1942 and 1943

Year	Liability Declared	Assessed Value	Overassessment Excess-Profits Tax	Deficiency
1942	\$ 67.78	\$ 77.78	\$10.00	
1943	1,334.34	0.00	0.00	\$1,334.34
Totals	\$1,402.12	\$ 77.78	\$10.00	\$1,334.34
		Income Tax		
1942	\$2,318.99	\$2,357.87	\$38.88	
1943	3,279.24	0.00	0.00	\$3,279.24
Totals	\$5,598.23	\$2,357.87	\$38.88	\$3,279.24
		Excess Profits Tax		
1943	\$171,827.06	\$120,495.29		\$51,331.77

In making this determination of your tax liability, careful consideration has been given to the report of examination dated April 19, 1945, to your protest dated July 19, 1945, and to the statements made at conferences held.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessments referred to in this letter, by filing with the collector of internal revenue for your district, claims for refund on form 843, copies of which were enclosed, the bases of which may be as set forth herein. [11]

A copy of this letter and statement has been mailed to your representative, Mr. John B. Milliken, 650 South Spring Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

Adjustments to Net Income
Taxable Year Ended December 31, 1942

Net income as disclosed by return.....		\$ 9,178.52
Unallowable deductions:		
(a) Franchise tax disallowed	\$2,000.00	
(b) Personal property taxes disallowed....	248.50	2,248.50
Total		\$11,427.02
Additional deduction:		
(c) Capital stock tax		2,400.00
Net income adjusted		\$ 9,027.02

Explanation of Adjustments

(a) It has been determined that the correct deduction for franchise tax, under section 23(c) of the Internal Revenue Code, is \$25.00 instead of the amount, \$2,025.00, claimed in your return, or a decrease of \$2,000.00.

(b) It has been determined that the correct deduction for personal property taxes, under section 23(c) of the Internal Revenue Code, is \$580.95 instead of the amount, \$829.45, claimed in your return, or a decrease of \$248.50.

(c) An additional deduction is allowed for capital stock tax in the amount of \$2,400.00.

Computation of Declared Value Excess-Profit Tax
 Taxable Year Ended December 31, 1942

Net income adjusted	\$9,027.02
Less: 10% of \$80,000.00 value of Capital stock as declared in capital stock tax return for the year ended June 30, 1942	8,000.00
<hr/>	
Net income subject to declared value excess-profits tax.....	\$1,027.02
Declared value excess-profits tax: 6.6% of \$1,027.02.....	\$ 67.78
Correct declared value excess profits tax liability.....	\$ 67.78
Declared value excess-profits tax assessed:	
Original, Account No. 359916	77.78
<hr/>	
Overassessment of declared value excess-profits tax.....	\$ 10.00

Computation of Income Tax

Taxable Year Ended December 31, 1942

Net income adjusted	\$9,027.02
Less: Declared value excess-profits tax.....	67.78
<hr/>	
Normal-tax net income	\$8,959.24
Surtax net income	\$8,959.24
Income tax:	
Normal tax:	
15% of \$5,000.00.....	\$750.00
17% of \$3,959.24.....	673.07
	\$1,423.07
<hr/>	
Surtax:	
10% of \$8,959.24.....	895.92
<hr/>	
Correct income tax liability	\$2,318.99
Income tax assessed: Original, Account No. 359916.....	2,357.87
<hr/>	
Overassessment of income tax	\$ 38.88

Adjustments to Net Income
Taxable Year Ended December 31, 1943

Net income as disclosed by return.....	\$211,857.16
Unallowable deductions:	
(a) Contribution to profit sharing fund disallowed	\$ 7,522.12
(b) Cost of camera disallowed.....	325.00
(c) Capital stock tax disallowed.....	2,500.00
(d) Franchise tax disallowed	8,000.00
(e) Real estate taxes disallowed.....	472.23
(f) Excessive compensation of officers disallowed	48,784.28
	67,603.63
Total	\$279,460.79
Additional deductions:	
(g) Depreciation on camera	\$ 5.42
(h) Amortization of emergency facilities	6,924.89
(i) Personal property taxes	1,121.26
(j) Excessive profits on war contracts....	51,192.00
	59,243.57
Net income adjusted	\$220,217.22

Explanation of Adjustments

(a) It has been determined that the deduction claimed in the amount of \$7,522.12, representing amounts set aside pursuant to a profit sharing agreement, does not represent a proper deduction under section 23 of the Internal Revenue Code and is disallowed.

(b) and (g) Included in the deduction claimed for employee relationship expense is the amount of \$325.00, representing the cost of a camera, which is disallowed because it represents a capital expenditure. A deduction in the amount of \$5.42 is allowed representing allowable depreciation on the camera from date of acquisition, November 10, 1943, based upon a life of 10 years.

(c) It has been determined that the correct deduction for capital stock tax, under section 23(c) of the Internal Revenue Code, is \$7,500.00 instead of the amount \$10,000.00, claimed in your return, or a decrease of \$2,500.00. [14]

(d) It has been determined that the correct deduction for franchise tax, under section 23(c) of the Internal Revenue Code, is \$1,539.51 instead of the amount \$9,539.51, claimed in your return, or a decrease of \$8,000.00.

(e) The deduction claimed for real estate taxes in the amount of \$472.23 is disallowed as not representing a proper deduction under section 23(c) of the Internal Revenue Code, this amount representing additional cost of land purchased June 18, 1943.

(f) On your return you deducted \$63,613.20 on account of a salary of \$8,800.00 and a bonus of \$54,-813.20 paid to your President and General Manager, H. L. Hoffman. It is determined that \$25,000.00 constitutes a reasonable compensation for services rendered by H. L. Hoffman, and the excessive payment in the amount of \$38,613.20 is disallowed as a deduction in computing your net taxable income for the year 1943 under the provisions of section 23(a)(1) of the Internal Revenue Code.

On your return you deducted \$22,171.08 on account of a salary of \$3,900.00 and a bonus of \$18,-271.08 paid to your Vice-President and Chief Engineer, W. S. Harmon. It is determined that \$12,-000.00 constitutes a reasonable compensation for services rendered by W. S. Harmon, and the excessive payment in the amount of \$10,171.08 is dis-

allowed as a deduction in computing your net taxable income for the year 1943 under the provisions of section 23(a)(1) of the Internal Revenue Code.

(h) An additional deduction is allowed for amortization of emergency facilities in the amount of \$6,924.89 in accordance with section 124 of the Internal Revenue Code, including amortization for six months with respect to the amount disallowed under adjustment (e).

(i) An additional deduction is allowed for personal property taxes in the amount of \$1,121.26.

(j) The amount of excessive profits on war contracts, determined pursuant to renegotiation of such contracts, in the amount of \$51,192.00 is eliminated from taxable income in accordance with section 3806(a) of the Internal Revenue Code. [15]

Computation of Declared Value Excess-Profits Tax

Taxable Year Ended December 31, 1943

Net income adjusted	\$220,217.22
Less: 10% of \$2,000,000.00, value of capital stock as declared in capital stock tax return for the year ended June 30, 1943	200,000.00
	<hr/>
Net income subject to declared value excess-profits tax....	\$ 20,217.22
Declared value excess-profits tax 6.6% of \$20,217.22....	\$ 1,334.34
Correct declared value excess-profits tax liability.....	\$ 1,334.34
Declared value excess-profits tax assessed:	
Original, Account No. 412153.....	\$782.57
Less: Credit allowed—Section 3806(b) I.R.C.	782.57
	<hr/>
Deficiency of declared value excess-profits.....	\$ 1,334.34

Adjustments to Excess Profits Net Income
Taxable Year Ended December 31, 1943

Excess profits net income as disclosed by return.....	\$211,074.59	
Unallowable deductions:		
(a) Contribution to profit sharing fund disallowed	\$ 7,522.12	
(b) Cost of camera disallowed.....	325.00	
(c) Capital stock tax disallowed.....	2,500.00	
(d) Franchise tax disallowed	8,000.00	
(e) Real Estate taxes disallowed.....	472.23	
(f) Excessive compensation of officers disallowed	48,784.28	67,603.63
Total		\$278,678.22
Additional deductions:		
(g) Depreciation of camera	\$ 5.42	
(h) Amortization of emergency facilities	6,924.89	
(i) Personal property taxes	1,121.26	
(j) Excessive profits on war contracts....	51,192.00	
(k) Declared value excess-profits tax.....	551.77	\$ 59,795.34
Excess profits tax income adjusted		\$218,882.88

Explanation of Adjustments

(a), (b), (c), (d), (e), (f), (g), (h), (i), and (j). These adjustments are the same as made to net income and previously explained.

(k) It has been determined that the correct deduction for declared value excess-profits tax, under section 23(c) of the Internal Revenue Code, is \$1,334.34 instead of the amount, \$782.57, claimed in your return, or an increase of \$551.77.

Adjustment to Unused Excess Profits Credit
Carryover

Taxable Year Ended December 31, 1943

In lieu of an unused excess profits credit carryover from the taxable year December 31, 1941,

claimed in the amount of \$2,354.37, it has been determined that the correct amount of such unused excess profits credit carryover is \$2,939.31, or an increase of \$584.94. This increase is due to an increase of \$443.44 in the amount of unused excess profits credit for the taxable year December 31, 1940 (carried forward to 1942) and a decrease of \$141.50 of excess profits net income for the taxable year December 31, 1942.

Computation of Excess Profits Tax

Taxable Year Ended December 31, 1943

Excess profits net income			\$218,882.88
Less: Specific exemption	\$5,000.00		
Excess profits credit (as claimed in return)	4,576.37		
Unused excess profits credit carryover.....	2,939.31	12,515.68	
		<hr/>	
Adjusted excess profits net income.....			\$206,367.20
(a) 90% of \$206,367.20			\$185,730.48
Surtax net income computed without reference to the credit provided in section 26(e).....			\$218,882.88
80% of \$218,882.88			175,106.30
Less: Income tax			3,279.24
		<hr/>	
(b) Balance			\$171,827.06
Correct excess profits tax liability (lesser of items (a) and (b)).....			\$171,827.06
Excess profits tax assessed:			
Original, Account No. 400816	\$168,859.67		
Less: Credit allowed Section 3806(b)			
I. R. C.	\$43,448.84		
Credit allowed Section			
124(k) I. R. C.....	4,915.54	48,364.38	\$120,495.29
		<hr/>	
Deficiency of excess profits tax.....			\$ 51,331.77

Computation of Income Tax

Taxable Year Ended December 31, 1943

Net income adjusted		\$220,217.22
Less: Income subject to excess profits tax..	\$206,367.20	
Declared value excess-profits tax.....	1,334.34	207,701.54
		<hr/>
Normal-tax net income		\$ 12,515.68
Surtax net income		\$ 12,515.68
Income tax:		
Normal tax:		
13% of \$5,000.00.....	\$ 750.00	
17% of \$7,515.68.....	1,277.67	\$ 2,027.67
		<hr/>
Surtax: 10% of \$12,515.68		\$ 1,251.57
		<hr/>
Correct income tax liability.....		\$ 3,279.24
Income tax assessed: Original, Account No. 412153.....		0.00
		<hr/>
Deficiency of income tax		\$ 3,279.24

[Endorsed]: T.C.U.S. Filed July 31, 1946. [18]

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are declared value excess-profits tax, income tax, and excess-profits tax for the calendar year 1943; denies the remainder of the allegations contained in paragraph 3 of the petition. [19]

4 (a) to (c), inclusive. Denies the allegations of error contained in subparagraphs (a) to (c), inclusive, of paragraph 4 of the petition.

5 (a). Admits the allegations contained in the first two sentences of subparagraph (a) of paragraph 5 of the petition; denies the remainder of the allegations contained in said subparagraph, and all subdivisions thereof.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

EARL C. CROUTER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Sept. 10, 1946. [20]

[Title of Tax Court and Cause.]

John B. Milliken, Esq., and Harrison Harkins, Esq., for the petitioner.

Earl C. Crouter, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Disney, Judge: This proceeding involves Federal income tax, declared value excess profits tax and excess profits tax deficiencies for 1943 in the amounts of \$3,279.24, \$1,334.34, and \$51,331.77, respectively.

The Commissioner allowed deductions as reasonable compensation for services rendered in the amount of \$25,000 for H. L. Hoffman, petitioner's president and general manager, and \$12,000 for W. S. Harmon, petitioner's vice-president and chief engineer, instead of \$63,613.20 and \$22,171.08, representing salaries and bonuses, as claimed on petitioner's tax return. [21]

The only question presented to this Court for determination is what is a reasonable allowance for salary or other compensation for the personal services actually rendered to the petitioner by each of the officers above named.

A stipulation of facts was filed. We adopt same by reference and find the facts therein set forth. Such part thereof as it is considered necessary to

set forth is included with other facts found from evidence adduced in our

FINDINGS OF FACT

Petitioner, a California corporation, was incorporated on June 30, 1932, under the name of Mission Bell Radio Mfg. Co., Inc. In 1943, without otherwise altering the continuity of its corporate existence, its name was changed to Hoffman Radio Corporation. The tax returns for the year 1943 involved herein were filed with the collector of internal revenue for the sixth district of California.

During the period from 1932 to 1942 petitioner was chiefly engaged in the business of manufacturing commercial radio receiving sets. A general order of the War Production Board, issued March 7, 1942, and effective April 23, 1942, restricted and finally prohibited the commercial manufacture of radio receivers and phonographs. During 1942 petitioner was engaged in the business of manufacturing radio and electronic equipment. Its percentage of sales of commercial radios, sub-contracts on Government orders, and experimental, as compared with the total sales that year was 31.61 per cent, 65.24 per cent, and .15 per cent, respectively. Its 1943 sales chiefly related to Government contracts and orders (99.96 per cent). The remaining part was commercial sales (.04 per cent). [22]

From the date of incorporation to 1941, inclusive, petitioner's operation was as follows: It sustained net losses in 1932, 1933, 1939, 1940 and 1941; it realized net income in the years 1934 to 1938. Comparative profit and loss statements for the years 1940 through 1943 reflect the following:

	1940	1941	1942	1943
Net Sales	\$121,812.16	\$ 29,763.82	\$351,950.62	\$ 1,787,850.14
Cost of Sales.....	99,677.60	30,930.30	259,365.15	1,354,803.95
Gross Profit on Sales.....	\$ 22,134.56	(\$ 1,166.48)	\$ 92,585.47	\$ 433,046.19
Other Income	839.81	3,769.74	1,448.57	.....
Total Income	\$ 22,974.57	\$ 2,603.26	\$ 94,034.04	\$ 433,046.19
Expenses (other than compensation of President and Vice President)	\$ 24,665.87	\$ 15,709.80	\$ 31,712.28	\$ 175,828.97
Net Income before compensation of Officers and before Federal Taxes	(\$ 1,691.50)	(\$ 13,106.54)	\$ 62,321.76	\$ 257,217.22
Compensation of President and Vice President.....	\$ 10,200.00	\$ 2,364.00	\$ 25,932.70	\$ 85,784.28*
Net Income before Federal Taxes.....	(\$11,891.50)	(\$ 15,470.54)	\$ 36,389.06	\$ 171,432.94*
Federal Income and Excess Profits Taxes.....	None	None	\$ 2,386.77	\$ 123,759.67*
Net Income after Taxes.....	(\$11,891.50)	(\$ 15,470.54)	\$ 34,002.29	\$ 47,673.27*
Dividends Paid	None	None	None	None

* Computation does not reflect the adjustment and tax deficiency on the deduction disallowance at issue herein.

Hoffman Radio Corporation vs.

Comparative balance sheets for the years 1941 through 1943 reflect the following:

	January 1 1941	December 31 1941	December 31 1942	December 31 1943
ASSETS				
Current Assets				
Cash	\$ 785.14	\$ 3,140.41	\$ 11,830.51	\$ 62,628.22
U. S. Treasury Notes.....	.....	.....	.....	50,000.00
Notes and Accounts Receivable.....	5,682.97	667.72	61,820.94	354,264.36
Inventories	13,930.60	9,128.53	52,618.16	242,061.96
Development Advance Receivable .....	.....	.....	.....	84,502.61
	<hr/>	<hr/>	<hr/>	<hr/>
	\$20,398.71	\$12,936.66	\$126,269.61	\$793,457.15
Fixed Assets				
Land, Buildings, and Machinery.....	\$ 2,718.65	\$ 2,456.65	\$ 21,062.89	\$ 84,434.59
Reserve for Depreciation.....	2,018.46	2,275.71	3,924.54	20,441.69
	<hr/>	<hr/>	<hr/>	<hr/>
Other Assets	\$ 700.19	\$ 180.94	\$ 17,138.35	\$ 63,992.90
	\$20,274.74	\$ 5,088.77	\$ 4,213.99	\$ 20,098.64
	<hr/>	<hr/>	<hr/>	<hr/>
Total Assets.....	\$41,373.64	\$18,206.37	\$147,621.95	\$877,548.69

LIABILITIES AND CAPITAL

Current Liabilities

	January 1 1941	December 31 1941	December 31 1942	December 31 1943
Accounts Payable	\$ 7,685.91	\$13,064.26	\$ 71,414.58	\$ 97,122.60
Notes Payable .....	.....	1,000.00	30,000.00	233,448.17
Accrued Expenses	1,199.27	1,254.83	9,317.80	151,935.40
Reserve for Federal Taxes.....	.....	.....	.....	137,146.38*
Reserve for Renegotiation.....	.....	.....	.....	51,192.00

Deferred Liabilities

Mortgage Payable	\$ 8,885.18	\$15,319.09	\$110,732.38	\$670,844.55
Reserve for Contract Guarantee.....	.....	.....	.....	\$ 27,000.00
				22,641.30

Capital Accounts

	\$	\$	\$	\$
Capital Stock—Preferred.....	.....	.....	.....	\$ 72,500.00
Common	41,300.00	41,300.00	41,300.00	41,300.00
Surplus—Paid in	10,373.71	10,373.71	10,373.71	10,373.71
Earned	(19,185.25)	(48,786.43)	(14,784.14)	32,889.13*

Total Liabilities and Capital.....	41,373.64	\$18,206.37	\$147,621.95	\$877,548.69
		\$ 2,887.28	\$ 36,889.57	\$157,062.84
	\$32,488.46			

* Without adjustment for the tax deficiencies in dispute herein.

H. L. Hoffman became interested in acquiring control of petitioner in July of 1941. He made a thorough investigation of its affairs and was conversant with its history, physical and financial situation, as well as its status and reputation in the radio manufacturing industry. In October or November of 1941, Hoffman interested G. Gifford Davidge and Walter D. Douglas in a plan to acquire stock and management control of petitioner. Davidge and Douglas were conversant with the history, physical and financial situation of the petitioner, and its status and reputation in the radio manufacturing industry. Both Davidge and Douglas were experienced in radio and electrical business. Douglas also had experience in the statistical and financial phases of the security investment business. Both Davidge and Douglas were men of means, each with a net worth of approximately \$750,000. Hoffman was not and is not now related to Douglas or Davidge, nor was he acquainted with them when the parties commenced the negotiations which culminated in their acquisition of stock and management control of the petitioner.

Hoffman, Davidge and Douglas reached an agreement, prior to the drafting and the execution of the formal documents involved, concerning the terms and procedures for acquiring stock and management control of petitioner. The formal documents embodying and effectuating the agreements were drafted at one time by Davidge's attorney. In brief, the preliminary agreement was that Hoffman was to enter into contracts to purchase, on an installment basis, all of the stock of petitioner; Hoffman

was to hold the stock interest so acquired as trustee for himself, Davidge and Douglas, and their respective beneficial stock interests were to be 50 per cent, 25 per cent and 25 per cent; each of the parties was to become a director and officer of petitioner; Hoffman was to be employed as general manager at a fixed salary to be later agreed upon, [25] plus an incentive compensation in a monthly amount equal to 3 per cent of the monthly gross sales; Hoffman, Davidge and Douglas were to loan cash to the petitioner in the amounts of \$2,000, \$4,000 and \$4,000, respectively, and the contributors of a majority in amount of the money advanced were to be entitled to determine what was to be done, or not done, in respect to the advances; and if at any time any two of the parties should determine that the operations of the petitioner could not be continued successfully, Hoffman was to make no further payments under the stock purchase contracts and the trust relative to the stock interest was to terminate.

Prior to December 1, 1941, petitioner's stockholders were as follows:

H. G. Schmieter, 110 shares.

Franklyn & Helen E. Warner, 193 shares.

P. L. Fleming, 110 shares.

Under the provisions of separate written agreements of December 1, 1941, and December 4, 1941, Hoffman agreed to purchase all of the 413 shares of the petitioner's outstanding stock previously belonging to such former stockholders, for the total sum of \$11,755, to be paid in installments. The agreement of December 1, 1941, between Hoffman

and H. G. Schmieter, provided in part that pending the making of payments for the stock, within 36 months, Hoffman should be employed as general manager and should be paid 3 per cent of the gross sales of all merchandise sold by petitioner, as a partial consideration for such services. The agreement had a provision as to dividends, as follows:

Hoffman shall in any event, at all times when he is not in default under the terms and conditions of this agreement, be entitled to receive, have and take all dividends which may be properly declared upon said stock; provided that in the event he is in default, his right to such dividends shall ipso facto cease and terminate. [26].

The agreement also provided that new certificates for the 110 shares of stock should be issued to Hoffman, then endorsed to Schmieter as collateral security for the payment. The agreement of December 4, 1941, between Hoffman and Franklyn and Helen E. Warner, similarly provided in part that pending the making of payments for the stock, within 36 months, Hoffman should be employed as general manager and should be paid 3 per cent of the gross sales for the preceding month, and in addition such an amount as may from time to time be agreed upon between Hoffman and the petitioner. The note which was a part of this agreement provided that the 193 shares of stock should be assigned, pledged and transferred to the Warners as security for the payment. The note also expressly reserved to Hoffman "all voting rights to the stock so assigned, pledged and transferred, and to all dividends paid thereon." The third agreement,

dated December 4, 1941, was between Hoffman and P. L. Fleming, relating to the purchase of 110 shares of the stock of petitioner by Hoffman and payment within 36 months. It contained the provision that Hoffman should be employed as general manager and should be paid 3 per cent of the gross sales for the preceding month, and in addition such an amount as may from time to time be agreed upon between Hoffman and the petitioner. It also contained a provision with respect to dividends as follows:

* * * Fleming further agrees, expressly for the benefit of said company as well as for the benefit of Hoffman, that he will not take any action to enforce his claim against said company for salary earned and unpaid prior to January 15, 1943, and that on January 15, 1943, he will agree to a further extension of the time of payment of such claim unless on or prior to January 15, 1943, said company is in a position to pay dividends on its stock aggregating the sum of Fifteen Hundred Dollars (\$1500.00), it being expressly agreed that, for the purpose of determining whether or not said company is in a position to pay such dividends, salaries paid to officers and/or employees of said company who during said year have been stockholders of said company shall be taken to aggregate not more than Twelve Thousand Dollars (\$12,000.00). [27] The note which was a part of this agreement provided that the 110 shares of stock should be assigned, pledged and transferred to Fleming as security for the payment. The note also expressly reserved to Hoffman "all voting

rights to the stock so assigned, pledged and transferred, and to all dividends paid thereon.”

After Hoffman acquired the stock from Schmie-ter, he became a director of petitioner. At a director's meeting on December 4, 1941, the directors being Hoffman, Fleming and one M. E. Penney, Hoffman was employed as general manager of petitioner. The terms of the agreement were set forth in an instrument dated December 4, 1941. The agreement provided, in general, for payment to Hoffman of 3 per cent of all gross sales for each preceding month, as partial payment for his services as general manager. Additional compensation was to be “such other amounts as may hereafter from time to time be mutually agreed upon.” The agreement was for 36 months, but terminable by Hoffman after February 28, 1942. After the approval of Hoffman's employment contract as general manager, Hoffman advised the Board that he had negotiations pending to acquire the remaining outstanding stock of the petitioner and thereupon requested the Board to adjourn and recess for 30 minutes, which request was granted. During the recess Hoffman consummated the transactions to acquire the remaining outstanding stock of petitioner. The meeting of the Board reconvened and upon proper motions, duly made, Davidge and Douglas were substituted as directors in the place of Fleming and Penney.

On December 9, 1941, Hoffman, Davidge and Douglas executed a contract setting forth the agreement of the parties to advance monies to the petitioner (\$2,000 from Hoffman and \$4,000 from

each of the others); that such parties shall be directors of petitioner; that Hoffman shall be president and general [28] manager and receive 3 per cent of the gross sales as part compensation for services; that Davidge shall be vice president, and that Douglas shall be secretary and treasurer. The contract also provided that all rights which Hoffman had in the stock, above mentioned, should be "held by him in trust for the benefit of himself, Davidge and Douglas * * *." The contract further provided that when and if Hoffman became owner of the stock, 50 per cent should belong to him, 25 per cent should belong to Davidge, and 25 per cent should belong to Douglas.

When Hoffman, Davidge and Douglas acquired their interests in the petitioner, as stated above, the main asset of the corporation was a license from the Radio Corporation of America, and one of the stipulations of the license was that it could not be sold or transferred. Consequently, it was necessary to rehabilitate the old company.

Petitioner, early in 1942, employed Walter S. Harmon, on a basis shown by letter of March 10, 1942, as follows:

Confirming our conversation and verbal agreement in January, this letter is to confirm our arrangement at that time. Mission Bell Radio Mfg. Co., Inc., will pay you a salary of Seventy-five Dollars (\$75.00) per week.

In addition to the above, we will pay you an overtime of one per cent (1%) on the gross volume

of business done by the Company after excise tax and other applicable taxes are deducted.

Payment of this bonus will be made annually and semi-annually if agreeable to both parties.

This arrangement will be applicable to the year 1942 and renewable upon the consent of both parties.

Later he was made vice-president.

Petitioner, by action of a majority of the board of directors (Hoffman and Douglas), on May 15, 1942, approved the above-mentioned salary and bonus [29] arrangement with Harmon. Minutes of this date also refer to business and authorize salaries as follows:

It was brought before the Board of Directors by Mr. Hoffman that contracts on hand with Bendix Aviation, Ltd., amounted to approximately \$300,000 and that prospects for future military work seemed to be promising. It was also pointed out that our present quarters were not adequate for the volume and type of work that we are doing, and they also do not meet the requirements of the Signal Corps.

* * * *

Salaries for executives of the Company were discussed. It was pointed out by Mr. Hoffman that it would be necessary to terminate his connection with Peerless Electrical Products Company because of his duties at Mission Bell Radio Mfg. Co., and thereby eliminate this source of income. To com-

pensate for this, motion was duly made, seconded and carried that his salary would be set at \$800.00 per month.

Motion was made by Mr. Hoffman that the salary of Mr. Walter D. Douglas be set up on the books at \$350.00 per month. Motion was duly seconded and carried.

On December 16, 1942, petitioner and Harmon renewed the arrangement of March 10, 1942, with respect to "salary and override commission of one per cent" for the year 1943.

On December 4, 1941, when Hoffman became general manager of petitioner, its physical plant and equipment were small and obsolete. It had no productive staff and its employees consisted of its then president, an office girl and a stock boy. The growth of petitioner's employee organization was as follows:

Year	Highest Number of Employees
1941	3
1942	107
1943	297
1944	351

In terms of plant expansion, petitioner progressed from its 1941 rented quarters encompassing 7,500 square feet, to a plant area of 15,000 square feet in 1942, and 40,000 square feet in 1943, including a one-story brick building [30] encompassing 18,500 square feet, which was purchased by petitioner for approximately \$55,000. (The \$25,000 down payment

was made from funds contributed by Hoffman, Davidge and Douglas.)

Salary and bonus payments and stock ownership of three of petitioner's officers, were as follows:

Name and Office	Salary and Bonus		Percentage of Stock owned
	1942	1943	
H. L. Hoffman, President and General Manager	\$18,688.52	\$63,613.20	50%
R. A. Yarcho, Secretary.....	2,483.25	5,762.26	None
Walter S. Harmon, Vice President and Engineer.....	7,244.18	22,171.08	None

Petitioner was located in a number one labor area which made it difficult to obtain contracts from the Army and Navy. Hoffman was instrumental in getting various people together, both in the Los Angeles and San Francisco areas, to form an association called West Coast Electronic Manufacturers Association, of which he was elected president. The association contributed substantially in helping the smaller companies to secure war contracts.

On recommendation of the Navy in 1943, petitioner was awarded the Army-Navy E award in 1944.

Under date of September 8, 1943, petitioner negotiated for a bank loan from the California Bank of Los Angeles. Among other provisions the agreement contained one prohibiting the payment of dividends by petitioner without the prior written consent of the bank. Petitioner paid no dividends in 1943.

Hoffman was 38 years of age in 1943. He received a degree of Bachelor of Arts from Albion College,

Michigan, in 1928, with a major in both business administration and philosophy. From 1928 through 1941, his compensation for services rendered other business firms was substantially as follows: [31]

1928 Sparton Radio.....	\$ 60 and \$75 a week
1929 Reynolds Spring Co. Football coach	
1929 Ellis Bishop Co.....	\$100 month plus addition
1929 Broadway Department Store.....	\$125 month
1930 to	
1935 Firestone Company	\$130 to \$300 month
1936 Firestone Store	\$275 or \$280 month
1937 Electrical Distributing Co.....	\$275 month
1938 In business for self	
1939 Sales Agent for Mfg. representa- tive business	\$1,900 year
1940 Lumber Mfg. Co.	\$4,700 year
1941 Peerless Electrical Manufacturing Co. (paying own expenses).....	\$13,000 year

During this period he gained experience in practical factory and machine work and methods; supervision of factory production and personnel, merchandising, developing distributor organizations, sales programs and service organizations; training factory and sales personnel; coordinating sales programs and factory schedules, and salesmanship. Part of his experience was in the line of electrical products, including radios and fluorescent lighting.

Hoffman was the only salesman and business solicitor employed by petitioner in the years 1942 and 1943. He obtained war contract orders in the amount of \$4,382,050.13 in 1942 and in the amount of \$881,244.81 in 1943. Production and delivery under the orders obtained in any one year was not necessarily limited to the year in which the order

was obtained. The war contract orders, above mentioned, were of the fixed price competitive bid type. Hoffman was also in charge of personnel. He observed a 14-to-16-hour day. Petitioner did not have a Washington, D. C., representative in 1942 and 1943.

The type of war contracts obtained and performed by the petitioner in 1942 and 1943, required the exercise of managerial, engineering, and mechanical skill [32] and inventiveness in design, production, procedures, tooling, testing equipment, and the efficient use of, or substitution for, materials which were critically short in supply; and many of the orders were of a type not solicited by comparable companies, or orders in the performance of which other companies had failed. The major war products produced by petitioner in 1942 and 1943 were frequency meters, variable condensers, antenna kites, phantom antennas, noise peak limiter and electronic relays, and electronic firing error indicators.

Harmon was 39 years of age in 1943. His compensation for services rendered other firms in years prior to 1942, were substantially as follows:

1926 Music Master Corp.....	\$35 wk.
1927 Distanttone Radios	40 - 50 wk.
1928 Dayfon Electric Co.....	35 - 55 wk.
1932 Zenith Radio Corp.....	60 - 65 wk.
1933 Utah Radio Products.....	65 wk.
1934 Emerson Radio & Phonograph Corp.	75 wk.
1936 Mission Bell Radio Mfg. Co....	50 wk. plus 10c each set sold
1940 Mitchell-Hughes Co.....	100 wk. (plus agreement for 50% of net profits, never received).

During this period he gained experience in the fields of radio engineering, design and development in both the automobile and household radio fields. While with Zenith Radio Corporation he developed the first practical single unit automobile radio made. While employed with petitioner, 1942 and 1943, he devoted his entire time to his engineering duties, working 16 hours a day, six days a week and sometimes part time on Sunday. He was also in charge of inspection. He spent some time visiting and conferring with other engineers in different sections of the United States.

The Continental Radio and Television Corporation, which was succeeded by the Admiral Corporation, was engaged in the business of radio manufacture [33] at Chicago, Illinois. In 1942 it had total net sales of about \$7,500,000, and in 1943 it had total net sales of about \$14,149,513. It had a net profit, after paying salaries and before payment of taxes, for 1943, in the amount of \$1,098,633. All of its 1943 business was from Government orders. The salaries of its officers remained the same in 1943 as they were in 1942, for which years they were substantially as follows: President, \$50,000; Vice President, \$35,000; Vice President, \$30,000; Treasurer, \$18,000; Assistant Treasurer, \$12,000; Secretary, \$15,000; Assistant Secretary, \$12,000; and Washington representative, \$8,600. Previous to 1942, it had been the habit of this corporation to increase salaries when it had a successful year. But no increase was permitted at this period, "according to law."

Gilfillan Bros, Inc., was incorporated in 1917, and was in active business in and around Los Angeles. It had been in the business of manufacturing household radios since 1922. It also manufactured electronic equipment, radar and aircraft mechanical parts. In 1941 an estimated 75 per cent of its business was military work and 25 per cent related to commercial radios. At the beginning of 1942 it was manufacturing radios and aircraft precision parts. For the fiscal year ended May 31, 1943, it had net sales after renegotiation in the amount of \$3,495,822.57. It had a net profit, after renegotiation and before payment of taxes, in the amount of \$306,949.64. The salaries of its officers for this period were as follows: President, \$32,432.40; Vice President, \$14,999.92; Vice President, \$14,999.92; J. G. Gilfillan [office undesignated] \$10,500; Vice President, \$8,400.08; Secretary-Treasurer, \$4,252.22. [34]

All of these officers except the Vice President, whose salary was \$8,400.08, were stockholders. The salary of the president had remained the same for a period of 15 or 20 years. The salary of its engineers for this period were as follows: Chief engineer, \$15,000; Assistant Engineer, \$12,000; Engineer, \$10,000. Its total number of employees increased in 1943 from 750 to 1,000 at the end of the year. The officers' salaries of Gilfillan Bros., Inc., were "frozen during the war years."

Reasonable compensation for services performed by Hoffman as president and general manager of petitioner for the year 1943 was \$40,000. Reasonable compensation for services performed by Harmon as vice-president and chief engineer of petitioner for the year 1943 was \$22,171.08.

OPINION

Section 23(a)(1)(A) of the Internal Revenue Code provides as follows:

Sec. 23 Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered;

* * * *

Petitioner claims the right, under this section, to deduct the following amounts paid as compensation to its officers in computing its net income for the taxable year 1943:

Name	Position	Amount paid
H. L. Hoffman,	President & General Manager.....	\$63,613.20
W. S. Harmon,	Vice-President & Chief Engineer.....	22,171.08

Respondent disallowed \$38,613.20 as to Hoffman's salary and \$10,171.08 as to Harmon's salary as "excessive compensation," thus allowing petitioner to deduct as compensation for its president and vice-president in computing its net income for 1943 the sums of \$25,000 and \$12,000, respectively.

The question, therefore, to be determined by this Court is, as previously stated, what is a reasonable allowance for salary or other compensation for the personal services actually rendered to petitioner by each of the above-mentioned officers during 1943.

“It is well settled that the question of what constitutes, for the tax deduction here in issue, reasonable compensation to a specific officer of a corporation, is essentially a question of fact to be determined by the peculiar facts and circumstances in each particular case.” *Miller Mfg. Co. v. Commissioner*, 149 Fed. (2d) 421, 422. See also *Capitol-Barg Dry Cleaning Co. v. Commissioner*, 131 Fed. (2d) 712.

Petitioner strongly urges that this case should be decided on the basis of regulations promulgated by the Commissioner wherein the rule is stated in Regulations 111, section 29.23(a)-6 (2) and (3) as follows:

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a fiat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the **individual made before the services are rendered**, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily [36] be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

Though the regulation might be considered none too clear, it is clear that the statute is of paramount weight and it requires reasonableness in salaries, so that the regulation must be understood as applying that test, even though there is contingent contract, also to be considered. The language of the regulation as to contract is limited by the language, consistent with statute, as to reasonableness. We have here considered both elements.

The Internal Revenue Code provides that the salary or other compensation paid or incurred in carrying on any trade or business must be reasonable. The regulations above quoted do not alter the plain meaning of the Code. There is no part of the regulation that provides, specifically, that any form of contingent compensation is exempt from the test specified in the Code, i.e., that it must be reasonable. On the contrary, the regulations provide that “any form of contingent compensation invites scrutiny” (emphasis added), further, “Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and

the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid." (Emphasis added.) Neither of these statements establishes the rule that a contingent contract for compensation, fair and equitable when made, is always to be considered binding at a later date and thereby exempt the corporation from showing the amount paid was reasonable. [37] The statement that any form of contingent compensation invites scrutiny is an indication that this section of the regulation does not exempt a salary from being reasonable. The sentence beginning with the words "Generally speaking" does not establish the rule as contended by petitioner, for the words themselves indicate that other requirements may be imposed. Section 29.23(a)-6 (3) provides that "In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances." The remaining portion of the section does not alter the conclusion that the amount paid must be reasonable.

Austin et al. v. United States, 28 Fed. (2d) 677, relied on by the petitioner, though stating generally that it is immaterial that the actual working out of a contract may prove greater than the amount ordinarily paid, concludes that "under the peculiar

facts" in that case, the contract was reasonable. The corporation, at the time of contract, was financially unable to continue in business and practically gave it up. In *William S. Gray & Co. v. United States*, 35 Fed. (2d) 968, some of the parties involved were not stockholders, there had for some years been a settled policy of compensation on a contingent basis, and the corporate earnings did not depend upon subordinates. The business, the court said, was unique, and the policy of paying on a contingency of earnings was a part of the business, necessary for its success. The salaries were found to be reasonable. Other cases cited are not found helpful.

Turning now to the question of what is reasonable compensation for each of the two officers here under consideration. The burden of proof, generally speaking, "is upon petitioner to establish the invalidity of the deficiency assessment." *Am-Plus Storage Battery Co. v. Commissioner*, 35 Fed. (2d) 167. [38] However, this Court may determine that an amount greater than that allowed by the Commissioner and less than that claimed by petitioner is a reasonable allowance for salaries or other compensation if the facts in the case justify such a conclusion. *Affiliated Enterprises, Inc.* 42 B.T.A. 390, reversed on other grounds, 123 Fed. (2d) 665; *Wagegro Corporation*, 38 B.T.A. 1225; *Heywood Boot & Shoe Co. v. Commissioner*, 76 Fed. (2d) 586.

In the light of the overall picture of the case before us, we cannot say that petitioner has established that the \$63,613.20, representing salary and bonuses, paid to Hoffman was a reasonable allow-

ance for ordinary and necessary expense for carrying on the business. We are not satisfied that the contract of employment, dated December 4, 1941, was the result of a "free bargain" between petitioner and Hoffman to secure his services, within the intendment of the regulation. Hoffman, at the time he contracted with the petitioner corporation itself, for the contingent salary here involved, was the owner of 110 of the 413 shares of stock, and a director, and had a contract for the purchase of the remainder of the stock. Also, he had a contract with the other individual stockholders, the Warners and Fleming (as with Schmieter from whom he had acquired the 110 shares), that he be made general manager on a basis of 3 per cent of gross sales. The contract for purchase of the Warner and Fleming stock was consummated on December 4, 1941, immediately after Hoffman's employment as general manager. All of this means to us that there was not in this matter the free bargaining and arm's length transaction, between a corporation and a proposed employee for services on a contingent basis, with which, under the regulation, there should not be interference.

At the time of the signing of the contract of employment between petitioner and Hoffman December 4, 1941, there is no indication but what the [39] parties thought that the business would continue the manufacture of radios as in the past. We realize that petitioner's business activities were in poor condition at the time Hoffman closed the negotiations for acquiring stock and management control

of it and that a great part of the success of the venture was due to his efforts. Conditions of the business had changed radically by the taxable year, here in question. In 1943 petitioner did an unusually large amount of business, attributable in the main, not to services rendered by Hoffman but to war conditions of the year. There is no indication that his services that year were of any greater value than the year before when he received a substantially smaller salary and bonus. In fact, the contrary may be true since he obtained war contract orders in the amount of \$4,382,050.13 in 1942 and in the amount of only \$881,244.81 in 1943. We cannot attribute the importance to Hoffman's services that is urged by petitioner. Under all the circumstances and facts, we have concluded that \$40,000 is reasonable compensation for Hoffman for the year 1943.

The contract of employment between petitioner and Harmon is on a different basis. We think it of much importance that Harmon owned no stock of petitioner, in fact had no interest in the corporation other than that of an employee. There was, therefore, "free bargain" between him and the petitioner for his services. The fact that he was later made an officer does not, in our opinion, change that relationship. At the time of the confirmation of his contract by petitioner's board of directors, May 14, 1942, this country was already in war and petitioner had already secured contracts for a large amount of business and it must have been apparent that a "first class engineer" would be needed. Har-

mon's testimony, at the hearing, impressed us. He was [40] largely the "brains" behind the production end of the business and, therefore, was entitled to a substantial salary for his services. Since Harmon had charge of production and production was much greater in 1943 than in 1942, it is reasonable to assume that the amount of work and responsibility would also be increased in the latter year. We have some evidence of payments to engineers in the amount of \$15,000 but no comparison of the duties, responsibilities, or hours required to work. On the other hand, Harmon worked long hours and had the responsibility of the engineering department.

Considering all the evidence, we have concluded that respondent erred in disallowing part of the salary and bonus paid to Harmon, and that the total amount paid (i.e., \$22,171.08) should be allowed as reasonable salary or other compensation for personal services actually rendered.

Decision will be entered under Rule 50.

Entered June 29, 1948.

The Tax Court of the United States
Washington

Docket No. 11683

HOFFMAN RADIO CORPORATION (Formerly
Mission Bell Radio Mfg. Co., Inc.),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion of this Court, entered on June 29, 1948, the respondent filed computation for entry of decision under Rule 50, on August 25, 1948, to which the petitioner filed his consent on September 20, 1948. In accordance therewith, it is

Ordered and Decided: That there are deficiencies in income and excess profits taxes in the respective amounts of \$3,279.24 and \$32,262.38 for the year 1943; and that there is no deficiency in declared value excess profits tax for the year 1943.

Entered Sept. 22, 1948.

(Seal) /s/ R. L. DISNEY,
Judge. [42]

The Tax Court of the United States

Docket No. 11683

HOFFMAN RADIO CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Court Room No. 229, United States Post Office and
Court House Building, Los Angeles, California.

December 11, 1947—10:00 a.m.

(Net pursuant to notice.)

Before: Honorable Richard L. Disney, Judge.

Appearances: John B. Milliken and Harrison Harkins, Room 808, 650 So. Spring St., Los Angeles 14, California, appearing for the Petitioner. Earl C. Crouter, (Honorable Charles Oliphant, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [1*]

PROCEEDINGS

The Court: We have Docket 11683, Hoffman Radio Corporation, formerly Mission Bell Radio Manufacturing Company, and for the Petitioner we have Honorable John B. Milliken and Mr. Harrison Harkins, and for the Respondent Mr. E. C. Crouter.

State your case for the Petitioner.

* Page numbering appearing at foot of page of original certified Reporter's Transcript.

Opening Statement on Behalf of the Petitioner
By Mr. Milliken

Mr. Milliken: May it please the Court, this proceeding results from a deficiency determined by the Respondent in income, declared value excess profits taxes, and excess profits taxes, for the calendar year 1943. The Commissioner proposed an aggregate deficiency of \$55,945.35. There are certain items that are not in dispute with respect to his determination, because they constitute overlapping items, the deductions of which have been received in years subsequent to the year 1943.

The Court: You can indicate those, Mr. Milliken, by the paragraph number in the petition.

Mr. Milliken: I have not alleged any error with respect to the later items.

The Court: I see.

Mr. Milliken: And they result in a deficiency of \$16,651.06, which left in dispute an item of \$39,-294.29.

That deficiency results entirely from the errors alleged in the petition, and relates to the disallowance of compensation paid to the president of the corporation and to the chief engineer of the corporation. H. L. Hoffman was president of the corporation and he was paid by the corporation a salary in 1943 of \$8,800.00 and contingent compensation of \$54,813.20, or a total compensation of \$63,613.20. The Commissioner has determined that \$25,000.00 constitutes a reasonable compensation for Mr. Hoffman's services, and has therefore disallowed \$38,613.20 of that sum.

The chief engineer, Mr. Harmon, was paid in the year 1943 a salary of \$3,900.00 and contingent compensation of \$18,271.08, or a total of \$22,171.08. The Commissioner has determined that \$12,000.00 constitutes a reasonable compensation for him for the year, and has accordingly disallowed \$10,171.08. That is the basis of the determination of the deficiency.

Counsel expects the evidence to show in this case, briefly, that in the year 1941 Mr. Hoffman entered into certain contracts for the purchase of the stock of Mission Bell Radio, whose name was changed to Hoffman Radio Corporation, only a change in name. At the time he acquired stock the corporation was in an insolvent condition. It had operated for the years 1939, 1940 and 1941 at progressive losses resulting from its operations, and he entered into a contract to revive the corporation and purchase its stock and to place it [4] on its feet. We think we will show that he has done a magnificent job in that respect.

On December 4, 1941, he entered into a contract whereby his compensation was to be measured by three percent of the gross sales of the company plus a nominal fixed salary. So we have a case where the contract was entered into long prior to the year whose compensation we are now concerned with. We expect the evidence to show that it was an arms-length transaction, fairly entered into with divergent interests who held the same interest in the stock of the corporation as did Mr. Hoffman; that at no time was he the owner of a majority of the

stock, either at the time the contract was entered into or during the year 1943.

We expect to show further—I admit I have difficulty even following the Commissioner's determination with respect to the chief engineer. He had no proprietary interest in the corporation, and has never had. Mr. Hoffman sought to employ a chief engineer of the requisite ability, and on an arms-length transaction they entered into a contract, whereby the basis of his compensation should be a nominal fixed salary of \$75.00 per week, plus one percent of the gross sales.

The Court: When was that contract entered into?

Mr. Milliken: That contract was entered into in 1942, the year prior, January of 1942, prior to the year 1943 with which the Court is concerned. It was an annual contract [5] renewable, it was renewed in December of 1942 for the year 1943.

It is difficult for me to follow the determination of the Respondent, for the reason that it seems to me that once the Petitioner has proven, which we expect to prove, that an arms-length contract was entered into long prior to the year whose services the Court is concerned with, that if it is a bonafide contract entered into at arms length, representing a true bargain, the Commissioner's own regulations provide for the allowance of contingent compensation pursuant to such contract, even though, as the regulations state in article 29.223 (a) (6) of Regulations 111—that that will be allowed, despite the fact that it is a much larger amount than would

ordinarily be paid, if the employee is willing to enter into such a type of contract. We expect, your Honor, that the judicial eye will consider when there has been proven that that contract was an arms-length contract, entered into before the services were rendered, entered into before the money was earned, and we are prepared, if the Court so determines, to show that it was reasonable even on a comparative basis.

I think that fairly states the grounds of this Petitioner.

The Court: Mr. Crouter. [6]

Opening Statement on Behalf of the Respondent
By Mr. Crouter

Mr. Crouter: May it please the Court, the outline of the case, particularly with respect to the amounts involved for the sole calendar year 1943 involved herein, have been stated by counsel for Petitioner, and I will not repeat those figures. I agree from the pleadings that the case in the basis under which it arises here is related to the one calendar year and the issue of the reasonable amount of deduction for compensation to Mr. Hoffman, the president and general manager of the Petitioner, and W. S. Harmon, vice president and chief engineer, in the amounts stated by counsel.

Now, I might state that in accordance with the practice we have stipulated a great many of the basic facts with respect to the operation of the corporation during 1943 and in some prior years, the amounts of income received, the amounts accrued

and paid to the individuals and so forth, so we will have no difficulty on those scores.

I would just like to emphasize, though, to help to explain to counsel if he is so mystified by the Respondent's position here, that I believe the evidence will clearly show to the court, both the stipulated evidence and the oral evidence which I apprehend will be submitted, that we have the rather unusual situation here in that, particularly as to Mr. Hoffman, we have an agreement of December 4, 1941. I stress that date, because that is three days before 1941. I stress that date, because that is the three days before Pearl Harbor. [7] This was the Mission Bell ciates, Mr. Davidge and Mr. Douglas, got into the corporation, taking it over through purchase agreements and so forth from prior stockholders and from the corporation, and they undoubtedly contemplated continuing in the radio business, radio assembly and sales organization. The evidence will show that that business by government orders was terminated for practical purposes, by an appropriate order after April 22, 1942, so that, like a great many domestic industries, they could not proceed with the radio business.

The evidence will show that particularly when Mr. Hoffman made the agreement of December 4, 1941, he undoubtedly contemplated a continuation of the radio business. And now in 1942—I will just be brief in this because that is fully shown in 1942 and 1943—the evidence will further show that this corporation, like a great many corporations, jumped right into the war business. There is no doubt whatever it contributed a great deal to the war effort.

It did a great deal of subcontracting and worked with other corporations, with the prime contractors. I believe the evidence will show that 99 percent or more of the business of this Petitioner corporation in 1943 was either with the prime contractors or the subcontractors and related to government business, particularly in the radio field. So that it is a war industry, as far as 1943 is concerned, it is a war [8] industry as far as the activities of these two officers are concerned, and it is almost totally unrelated to the prior radio business which they had and which the compensation agreement contemplated.

The evidence will also show, if the Court please, that Mr. Hoffman was the 50 percent stockholder. He had an agreement whereby he would acquire all of the stock. There were only 413 shares outstanding. Mr. Hoffman did acquire all of the 411 shares in his own name, but he had an agreement with his two associates to acquire and buy the corporation, whereby after they were paid certain amounts they would become 25 percent stockholders, each, and Mr. Hoffman was to hold all shares of the stock in trust for the benefit of his other two associates until all of their initial investments were returned to them.

The Court: Was that agreement in effect at the time the contract was made?

Mr. Crouter: I believe it is dated about the same date. It is a part of the same plan, at that time. My main point there is that Mr. Hoffman was a 50 percent stockholder of the corporation prior to

the salary agreement date, and he was general manager of the Petitioner, he was president of the corporation, and undoubtedly one of the main motivating factors in the organization, so that the dividend base of the case does come into the picture, particularly from the [9] tax standpoint. No dividend as such was recognized or paid to any stockholder in the year 1943, and that, of course is a part of the picture from the Commissioner's standpoint.

Our position, briefly, is that the company did a lot of business, it did a good business, it made a good deal of income in 1943. It came out with a very good net income. We stipulate that there was a net income before deduction of compensation of these two officers and before federal taxes of \$257,-217.00. There are a great many other figures I will not burden the Court with, but that shows somewhat that it was a sizeable undertaking, and there should have been some recognition of the claim for return of investment here by stockholders, and some part of those profits clearly should be allocated to dividends. Some of the earlier agreements provide for payment of dividends to Mr. Hoffman, but the dividend phase of it was wholly neglected during these years.

Our main position, of course, is that the compensation which was paid and payable to these officers, and I believe all of it was paid during the calendar year, therefore there is no question of the two and one-half months requirement or anything of that sort in the case so far as I know now—our position

is that the amounts paid to these officers were unreasonable, say in connection with the whole deal and in connection with their services rendered, and also in connection with the question of some substantial return [10] for the capital investment, which was rather considerable. I will not attempt to indicate the figures on that, because I believe that changed a good deal during the year 1943, but there was a substantial plant investment here also, so that a large part of those profits, in our determination and position here, in fact constitute dividends of the Petitioner and should be treated accordingly and should not be deducted as compensation of the two main officers in the organization.

The Court: How do you relate this regulation, Mr. Crouter, into this situation? I have been interested in this regulation for some time and have had occasion to consider it. How do you relate that into this situation? I have in mind a rather dull and indefinite way perhaps, this theory: is it in your mind the fact that the situation changed because of the war's effects perhaps wipes out to some degree the effect of the regulation? What is your thought about that?

Mr. Crouter: I don't know whether this is a complete answer, but it appears to me that we still have the statutory requirement of reasonable compensation. It must be reasonable in connection with the business done and the services rendered and required and so forth. I appreciate that the regulations have gone quite far in recognition of contingent arrangements, but I do not believe that such

arrangements can be wholly recognized or sanctioned in the [11] cases where they just take all of the available profits and earnings of the company and treat them as compensation.

The Court: I am not passing on that question at all at this time, because I realize the final ultimate question is to be determined by the statute, but I was wondering whether you had the idea that the regulation was more or less not to be considered because the contract is made before the incidence of a brand new situation, so to speak, such as the war. Well, is there anything further in the way of a statement from Petitioner?

Mr. Milliken: No, I believe not, your Honor.

The Court: Put on your evidence.

Mr. Milliken: I should like to introduce at this time a stipulation of facts entered into by counsel for the respective parties.

The Court: File the stipulation, Mr. Clerk, and the facts therein set forth will be received in evidence.

Mr. Crouter: If I may do so at this time, I have told Mr. Milliken beforehand and Respondent objects to the portion of paragraph XVIII on page 6 of the stipulation, and we reserve our right to object in the first paragraph. Our objection there, if the Court please, is—

The Court: XVIII, you say?

Mr. Crouter: The bottom of page 6. Our objection there is that the figures included there with respect to [12] employees in the subsequent years, 1944, 1945, 1946 and 1947 to date are irrelevant and

immaterial and really have no place in this proceeding. It seems to me that things that happened subsequent will not help establish anything as to what was a reasonable compensation in 1943. That is the basis of the objection.

The Court: Well, sometimes later matters than within the limits help, and sometimes they are really immaterial. It depends a good deal upon the case. Without knowing any more about the case than I do at this juncture, I would not want to sustain your objection on that ground. This is not a jury case. I mean, at least I trust I will not give undue weight to anything that I may consider. Objection overruled and exception allowed. I don't mean to indicate by that I am now deciding the whole thing, and you may bring that up later, when I can judge that as we go along.

Mr. Milliken: May it please the Court, as I understand, the counsel for the Respondent, that his only objection to this stipulation, on the ground of irrelevancy and immateriality, that he requested to be placed in the first paragraph of the stipulation. I ask that for the reason that if there are some other objections which he has to this stipulation on the grounds of irrelevancy and immateriality, then I should like to know them, because the witnesses could be questioned accordingly. [13]

Mr. Crouter: That is the reason I raised the objection, and I told the counsel in advance that was the only objection I would raise, and that is the only objection I have to any part of the petition.

Mr. Milliken: I will call Mr. Hoffman.
Whereupon,

H. LESLIE HOFFMAN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you tell us your name, Mr. Witness, please?

The Witness: H. Leslie Hoffman.

Direct Examination

By Mr. Milliken:

Q. Your name is H. Leslie Hoffman?

A. H. Leslie Hoffman.

Q. During the year 1943, Mr. Hoffman, were you employed?

A. I was employed by Mission Bell Radio Manufacturing Company as president and general manager.

Q. When did you first acquire your interest or employment with the Petitioner in this case?

A. My interest started away back in July and August of 1941. My actual employment took place on December 4, 1941.

Q. Mr. Hoffman, are you a graduate of any university? [14]

A. I am a graduate of Albion College, Albion, Michigan.

Q. Will you please start with your graduation from college and briefly outline to the Court what your employment had been up to December 4, 1941, and the capacity in which you were employed?

A. Well, starting in with college, I was another one of those fellows that had to work their way

(Testimony of H. Leslie Hoffman.)

through college, and I had a job as janitor in the bank there, and also started a clothing business on a consignment basis and a laundry business, so when I graduated from college I had three businesses operating, and I was planning on going on to do graduate work, but things at home were such that I had to go to work full time, and I went to work for Spartan Radio Company in Jackson, Michigan. I went to work there in the capacity——

Q What year was that if I may ask?

A. That was in 1928. I went to work there as a stock clerk and gradually progressed to the point of line foreman, and at that particular time the radio business was pretty good and we had to step the production up from 70 units to a good deal in advance of that. This was done satisfactorily, and I was given the job then, even at a young age, as night superintendent of Spartan Radio, in which I had approximately twelve hundred people under my jurisdiction. I stayed with Spartan until the summer of 1929.

Q. May I interrupt you. What business was the Sparton [15] Radio Company engaged in?

A. Well, Sparton Radio, actually the name of the company was Sparks-Withington Company, and they built the Sparton radios and Sparton horns, and the horns were sold direct to manufacturers and the radios were sold through distributors and dealer organizations.

I went from Sparks-Withington to a company called Reynolds Spring Company in Jackson. I happened to coach football on the side and was

(Testimony of H. Leslie Hoffman.)

working twelve hours at night, and they were interested in starting a lighting system for lighting stadiums, and when I got over there I found they were not quite ready to do it, so I took a job as foreman of their production assembly department. The things that were produced and assembled were Bakelite toggle plates and metal lights and things of that kind, and I stayed with them until the latter part of 1929.

Then I came out to California in about the early fall of 1929 and I went with a company out here called the Ellis Bishop Company. I didn't know anyone out here and didn't have any contacts, so I started out to become an investment salesman. Well, that lasted about sixty days, because, I think everybody remembers September of 1929, and there was no investment business.

After that I went over to the Broadway Department Store here in town as a trainee and due to my previous [16] experience in my own stores and when I was in college and prior work, working vacations and so forth, I did know something about the merchandising business, and I stayed with the Broadway until the early part of 1930, when I took a job with Firestone and I stayed with Firestone quite a period of time in various capacities. My first capacity was a clerk, and I was transferred from there to a college trainee class, and then I became assistant to the battery sales manager for the eleven western states, and in 1931 I was given the job of battery sales manager for the eleven

(Testimony of H. Leslie Hoffman.)

western states. My job in that particular position was to—at that time Firestone was just going into the merchandising of these various products. They, of course, had built up the distribution and buyers, but they had no distribution on these particular products, and it was my job to go out and show the salesmen how to sell batteries and develop programs that would sell batteries. During that short period of time when I handled batteries exclusively I developed an oil company merchandising unit designed to go out in the field for Firestone and open an entirely new distribution program for Firestone through the various oil company stations, such as Union Oil Company and so forth. Due to that particular work I was put in charge of the oil company business for a period of time and I had the job of training some two thousand oil company attendants in the proper merchandising of these various products, tires, batteries and spark plugs.

During the depression, of course, the ax fell there as well as other places, and from 1932 to 1933 I took over five different departments. Those particular departments were brake-lining and spark plugs, accessories and repair material, motor-cycle tire and air plane tires, and about that time the total sales of all those departments were running around four or five hundred thousand dollars, and during the next eighteen months I took that up to roughly around three and a half million, and that involved working out a multitude of problems for manufacturing, because we were just going into

(Testimony of H. Leslie Hoffman.)

the manufacture of batteries and brake-lining, and the actual merchandising of it. Our territory embraced the eleven western states. We had seven district offices with district managers in each of these districts, each having from five to fifteen wholesale salesmen as well as a good many retail stores actually owned and operated by Firestone.

In 1933, the latter part of 1933, I had to go back to Akron to work on some of these merchandising programs and also attend the various conferences in Chicago, and on my return I became quite ill and subsequent developments indicated I had to have a major operation, and due to the operation it eliminated the possibility of my traveling for a period of time, so I was transferred to operate the retail store in Portland, Oregon, the Firestone retail store. This store had [18] shown a substantial loss the previous year, and I was successful in working about twenty hours a day to transfer it from a deficit to a substantial profit. I was also successful in introducing a few new policies that Mr. Firestone himself was acquainted with and adopted, such as a pension program for the employees and a few other things.

I left Firestone in the latter part of 1936, primarily due to the fact that I could take it but I couldn't dish it out, because right at that time they were asking college fellows to work for fifty-five and sixty dollars a month, and all it was causing was a lot of pilferage of the till and so forth. I tried to get them to change their policies, but they

(Testimony of H. Leslie Hoffman.)

established my salary scales and things like that, so I couldn't do anything about it, so I took a job with a company in Portland, Oregon, starting in 1937, called the Electrical Distributing Company. This Electrical Distributing Company was a wholesale distributor of appliances and radios. They had the Zenith radio line, the ABC Washers, and a good many other items. My job was merchandising, general manager, and it so happened that the owner of this business had several other interests and he wanted somebody to operate the business. I had direct charge of the entire sales force, which consisted of seven men, and the inside operation of about ten people, and during 1937, which was normally a bad year, we took the sales from around four [19] hundred thousand to up to seven hundred thousand. The operator of this business had promised me a participating deal, which he refused to go through with, the latter part of the year, and I didn't particularly care for Portland anyway, so I left and came back down here with the very definite determination that I would be in business for myself from that point forward, or at least as close to it as I could come, and I worked in 1938 and went back east several times to get lines to represent as a manufacturer's representative out here, and was successful in getting a refrigerator line and a radio line and a few other lines, and it was in this manufacturer's representative business I became interested in fluorescent lighting, and I could see the possibilities of fluorescent lighting,

(Testimony of H. Leslie Hoffman.)

and I couldn't get the right connection in the east, so I designed a lamp and got a company called the Lumidor Manufacturing Company to build it, and I took over the sales of the fluorescent end of their business. We built a double fluorescent table light and we built a light fixture for offices and lighting fixtures for factories, and we did fairly well with it, but another problem came in this, and that was, here in Southern California, you have a large percentage of 55-cycle current. The General Electric and some of those other manufacturers did not build 50-cycle transformers, and in trying to get a 50-cycle transformers I covered the front here of the various transformer [20] manufacturers here and I got the Peerless Electrical Products interested in building a 50-cycle transformer, and worked out a program with them to handle their sale of the fluorescent transformers. It became evident the latter part of 1940 that my activity with Peerless would conflict with my activity at Lumidor, so I came to a pleasant understanding with Lumidor and devoted all my time to Peerless. At that time Peerless' business, as I recall it, was between sixty and seventy-five thousand dollars a year, and due to the increase in volume that I generated their business went up about four or five times that much, and of course that brought in a good many problems of manufacturing and a few things like that and I had to spend quite a lot of time on the inside trying to help out on that score.

(Testimony of H. Leslie Hoffman.)

In along about July of 1941 Peerless was under-financed, and they brought in a financial arrangement with one of the banking houses here, and they brought in a manager that wanted to change my entire program. However, that was worked out, and I still have the—I was trying to get a participating interest in Peerless but that was not possible, at least they said it was not, so I wanted to get some kind of a deal where I could participate to get my share in the results of my generating—the results of my ability, which I had been trying to do for quite a period of time. At that particular time I found out about Mission Bell. Due to the fact—

Q. May I interrupt you please, Mr. Hoffman. When you were employed by Lumidor Manufacturing Company, by Peerless Electrical Products Company, what were the terms of your employment, how were you compensated in your employment?

A. Well, with Lumidor I worked on a straight 10 percent commission.

Q. A 10 percent commission? A. Yes, sir.

Q. Of the sales?

A. Of the gross sales, after any taxes.

Q. Of the gross sales?

A. That is right, after any taxes.

Q. With respect to Peerless?

A. With respect to Peerless I started out at 10 percent, then I had a sliding scale.

Q. Was that 10 percent of the gross sales?

(Testimony of H. Leslie Hoffman.)

A. Yes, sir, then we had a sliding scale depending on whether or not it went to Nevada or Washington, and it was 10, 8 and 5

Q. What was the business when you took hold of Lumidor as sales representative, in round dollars, and what was the volume of their business in round dollars, and what was the volume of their business in round dollars upon your combination of employment with them?

A. I don't know those figures, Judge, but I do know [22] how much business that I developed for Lumidor. It was approximately an additional fifty to seventy-five thousand dollars.

Q. And with respect to Lumidor, Lumidor Manufacturing Company, what was your compensation received with respect to this 10 percent?

A. As I recall it, it was around \$4500.00.

Q. And what did you receive in the year 1941 from Peerless Electrical Products Company?

A. I received around thirteen thousand dollars in the year 1941.

Q. Did you have a reason for leaving the Peerless people?

A. Yes and no. I was still looking for this kind of a deal that I could get in on a basis where I could share not only on a percentage basis but build something up of material consequence to myself, and that was the reason I was looking around for something else, but I still had my connection with Peerless at the time that I went into the Mission Bell picture.

(Testimony of H. Leslie Hoffman.)

Q How did you first learn of the Mission Bell Radio Manufacturing Company?

A. Well, I knew of the Mission Bell because the Peerless Electrical Products were selling transformers to them and I had worked there and naturally I knew of that. Then I also heard about it in the street that they were very much in [23] trouble, and it was suggested by some friends of mine that I ought to go over and talk to them and see if I could work out a program to rehabilitate the company.

Q. Did you make an investigation with respect to the financial condition and the sales volume and reputation of the Mission Bell in the year 1941?

A. Yes, I did. I made a very thorough investigation.

Q. What did your investigation disclose?

A. Well, my investigation disclosed that the company had generally lost money from 1936, and that in 1940 they had worked out a program with some promoters in Hollywood who had the stock tied up for about a year, and the company was just standing there with nobody doing anything about it. It also disclosed that the lease on this controlling stock was expiring and that although the company was in an insolvent condition something could be done to rehabilitate it. I found that they had, number one, they had sold a certain percentage of their product to Sears, Roebuck. They did have an RCA license, which was necessary to a company building radios. However, the value of that was considerably

(Testimony of H. Leslie Hoffman.)

depreciated due to the loosening up by RCA and giving that to most any reputable manufacturer; by the latter part of 1941 as subsequent developments occurred, there was no necessity to have a license. But I also found that the company had three employees there, Mr. Fleming, president of the company, his [24] office girl and a red-headed boy in the shipping department. That was the entire organization, and it was just in stagnant condition.

I went there and went over the facts with Mr. Fleming, trying to find out what chances it had and whether it was worth going into, and I found that it didn't have very much.

I also, as a matter of fact while I was there at the time of my first interview, the sheriff was around with a sign and he was about to tack it up, and with a little gymnastics on Mr. Fleming's part he avoided that but it was just a matter of time before the place was closed up, particularly due to the fact that the creditors were—I couldn't see any place where they would get any money.

Q. Did you investigate the profit position of the company for the year 1941, or did you ascertain the sales made by the company and the profits during the year 1941? A. Yes, sir.

Q. What was that?

A. Well, of course sales were only \$29,000.00 and the loss was \$15,000.00.

Q. Do you recall—the sales were \$29,000.00 Do you recall the cost of the sales?

(Testimony of H. Leslie Hoffman.)

A. I think it was greater than the \$29,000.00. As I recall, it was \$30,000.00 or \$32,000.00. [25]

Q. Well, it is stipulated that the cost of sales was \$30,000.00, and you investigated and found they had a loss of \$15,000.00 for the year 1941?

A. Yes, that is right.

Q. Had Mission Bell at any time since it was incorporated, and we have stipulated that it was incorporated in 1932, had it ever operated at a profit?

A. Yes, it had operated at a profit in 1936, was its biggest year, and as I recall it they did something like \$350,000.00 worth of business, and made around \$8,000.00, and of course with the business, the way I visualized it, the business was not doing—they were not doing the volume of business that could be done, nor were they managing the business in such a way that they made the maximum amount of money that could be made.

Q. We have stipulated, Mr. Hoffman, that for the years 1939, 1940 and 1941, Mission Bell's respective losses from operations or in round figures were \$8,000.00, \$11,000.00 and \$15,000.00 per year. Was that fact made known to you?

A. Yes, it was.

Q. And what did you do with respect to making further investigations, if you did make any, incident to acquiring stock of Mission Bell?

A. Well, there were quite a few things I had to do. In the first place, there was a good many skeletons that [26] had to be taken out of the closet and buried. The first thing I ran into was that Mis-

(Testimony of H. Leslie Hoffman.)

sion Bell was owned by two men, a chap by the name of Schmieter and a chap by the name of Fleming. I found that they were not getting along too well and couldn't get together on any of their ideas, and Schmieter had left the company and taken another position. And then I also found that the other chap, Warner, who had purchased the controlling stock, was in serious trouble with some movie interests that he had, and so I had to find out what kind of a deal could be made to get Schmieter's stock, Warner's stock and Fleming's stock, and of course I investigated that phase of it, and I investigated what the potential business would be, that is both through the private brand manufacture and through the franchise sales. I found that Mission Bell in one way had caused a great deal of animosity on the part of the dealers, inasmuch as they would sell the retail trade at about the same price they would sell the jobber, so there was a certain amount of animosity there, but in talking to some of the dealers and so forth I felt that that could be overcome. And so my preparatory work as I say was done in the latter fall of the year, as to finding out what kind of a deal could be made with the stockholders if we were successful in raising the money to rehabilitate the company.

Q. Did you know what the stock could be purchased for? [27] A. Yes, sir.

Q. Did you have the capital with which to purchase the stock? A. No, sir.

(Testimony of H. Leslie Hoffman.)

Q. Where did you seek to raise the capital, if you did seek it?

A. I didn't have the money to buy the stock, and it was my opinion, which has subsequently been substantiated, that everything that could be done to cut down the amount of expenditure by the company for operating expenses and everything that could be done to make and improve the business should be done. In other words, it was my complete feeling from the origination of the thing if we did interest some capital, the capital should go into the business, not to pay for the stock, and that the stock should be paid for as the company was pulled out by its bootstraps by myself, and that was the sort of project we went into, and of course that was a kind of hard deal to sell from a financial viewpoint.

Q. Were you able to interest other people in the deal of this fashion?

A. Well, I was able to interest other people but it was not exactly easy. In the first place, I wanted to find somebody who knew something of the radio business so they would understand the problems of the rehabilitation of this company. I wanted to find someone with sufficient capital [28] so that if the company did progress that we could continue the progress of the company, and towards that end I started a door-to-door canvass of Spring Street down here to see if I could find somebody that would sort of fit that description. I had several contacts that wanted to put money in it and I had

(Testimony of H. Leslie Hoffman.)

several people who had the confidence in me and said you take it and do what you want to do with it and we think you are worth it and so forth, but that was not the kind of a deal I wanted. I wanted a business deal and I frankly wanted somebody I didn't know too well socially to go into it on a business basis with me, and in making the rounds of Spring Street I ran into a lead at the Nelson Douglas Company down here and they told me about Mr. Douglas, Walter Douglas, who had been with them and was interested in the radio business, who had already financed a couple of other radio operations, and suggested that I go to see him, and I went around and found they were in the back of—had offices in the back of Edgin Company. I knew Mr. Edgin from previous contacts, and I told him what I was there for and he says, "Oh, hell," he says, "we seen that thing and set it aside, no use talking to him about it." I said, "Well, I would like to give it a touch anyway, and I would like to tell him what my ideas are on it." So I went back and talked to them, and I had an operating statement, past sales, and their current financial position, and they didn't know me and I had to sell myself to them, and then I told them what my ideas were of the thing, and that is that any money that we did raise, and we had to have an extra amount of money to ward off the creditors and work out, I talked to some of the creditors and found that I could work out a time-payment basis on the accounts payable, and that the rest of the money

(Testimony of H. Leslie Hoffman.)

should go into the business to rehabilitate the business, and that the stock should be acquired on some such basis whereby that we could pay for it over a period of time, and so we discussed it.

Q. What do you mean "we," who is called "we"?

A. Mr. Douglas, Mr. Davidge and myself, and we finally came out with the formula on the thing of how to do it, and Mr. Davidge suggested that we go to see his attorney, which we did, and his attorney, Mr. Irving Walker at that time, Walker, Adams & Duque, worked out these various contracts, and we worked them all out at the same time. One was sort of synchronus with the other.

Q. What time in the year 1941 did you have these conversations of which you spoke with Davidge and Douglas?

A. Well, it was in October, November. I remember I had a hard time getting both Douglas and Davidge, because it was just the opening of the duck season and I had a hard time finding them, and it was either in October or November that we had the conversations, and of course it took quite a period of time, because I couldn't devote all of my time to [30] it at that time to get all these bases of agreements with these various people.

Q. Had Davidge and Douglas known of you before you met them incident to this deal?

A. No, sir.

Q. Are they related to you in any manner?

A. No, sir, they are not.

(Testimony of H. Leslie Hoffman.)

Q. Did you know that they had been in—what business they had been in before, Davidge and Douglas?

A. Well, that was—of course what I was after was somebody that knew something about the radio business, and they had operated the Standard Utilities Company, which was the Farnsworth distributor in this area.

Q. Farnsworth Radio?

A. Farnsworth Radio, yes, sir. They had also been in a company called the Edgin Company, that was the service parts and wholesaler for Philco and Motorola, car radios, and in addition to that they had an appliance establishment, which was sort of a retail adjustment operation in refrigerators and stoves and that sort of thing, so they had been in the business for a period of time, particularly from the distributing end of the business.

Q. What arrangement did you make with them, if you remember, with respect to the capital they were to invest or what interest they were to have in this company, assuming [31] you could acquire all of this stock?

A. Well, the program was that I would put in two thousand dollars and they would put in four thousand dollars apiece, making a total of ten thousand dollars, and they were each, each of those, that is Douglas and Davidge, would receive 25 percent and I was to retain 50 percent.

Q. That is, Davidge and Douglas each have 25 percent of the total common stock outstanding?

(Testimony of H. Leslie Hoffman.)

A. Yes, sir.

Q. And you would have 50 percent of the common stock?

A. Yes, sir, that is right, and there were further stipulations or arrangement, whereby each of the two people who put in the majority of the money could close up the company at any time that they wanted to, or take any action as far as the financial position of the business.

Q. Did you discuss with Davidge and Douglas what should be the terms of your employment and compensation to be received?

A. Yes, sir. I explained it to them how I had been working on a commission basis and wanted to continue that because I believed in incentive compensation, and I also discussed with them the fact that the company couldn't pay any salary, and that they were going to have to pay me a salary, and that I would demand that they would automatically sink any cash back immediately for material. We discussed various means and deals [32] and finally settled on a basis of this 3 percent program, which was considerably less than I had been making percentagewise, but it was——

Q. You say 3 percent deal. Three percent of what?

A. Three percent of the gross sales after taxes.

Q. I see. Did Davidge and Douglas assent to that or did they dissent?

A. Well, they naturally assented to it, because in the first place we drew up the contract together,

(Testimony of H. Leslie Hoffman.)

I mean Davidge's counsel drew up the contract, and it was the result—we went in and told them what we wanted, it was the result of our conversations, and then he drew it up.

Q. Then, as I understand it, the total outstanding stock owned by Schmieter and Fleming and Warner, you were to acquire that under contracts from them, is that correct?

A. Yes, sir, that is right.

Q. Did you enter into any agreements with Davidge and Douglas with respect as to how that stock should be held by you for their benefit?

A. It was to be held as the trustee by me, and I fixed it or the attorney fixed it that I acquire the stock from the original owners, but I had a contract with them that during the period of time that we were acquiring this stock they had a 25 percent interest, and that after the stock was acquired that it would be automatically turned over to them. [33]

Q. That is respective 25 percent portions?

A. Yes, sir, that is right. [34]

Q. It has been stipulated, the contract whereby you bought this stock from Schmieter, Warner and Fleming. We have also stipulated the contract which you have with Douglas and Davidge, and did their attorneys draw up the employment contract?

A. Their attorneys drew up the employment contract.

Mr. Crouter: If your Honor please, I will ask that be specific, because we have two or three employment contracts, and I want to know as the basis for cross examination.

(Testimony of H. Leslie Hoffman.)

Q. (By Mr. Milliken): Did you have an employment contract there after you had required this stock, after Douglas and Davidge had agreed to provide the capital, did you enter into an employment contract with Mission Bell?

A. Yes, sir.

Q. On what date?

A. Well, the employment contract was drawn up, as I say, by Irving Walker, who was Davidge's counsel. However, he recommended that the former board of directors accept the contract, that is vote on the contract, and at the same time elect Davidge and Douglas as the other two members of the board of directors, and so consequently Irving Walker drew up my employment contract, and then there was a meeting of the board of directors, of the former board of directors of Mission Bell, and——

Q. Just a moment.

A. We were asking——

Q. Just a moment, Mr. Hoffman.

A. O. K.

Q. We have stipulated Exhibit 14, an agreement purportedly entered into between yourself and the Mission Bell Radio Corporation?

A. Yes, sir, that is right.

Q. Is that the employment agreement of which you speak?

A. That is the employment agreement.

Q. And that employment agreement, prior to having been entered into, was fully discussed with Davidge and with Douglas?

A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. It was with their approval?

A. Very definitely.

Q. And did they insist upon it?

A. They insisted that we use this formula that we are talking about, No. 1, that there should be an inventive, No. 2, that anything taken out in the way of returns or salary would be only as the company progressed, and this three percent was what we decided upon between the three of us, that is after negotiating back and forth. I asked for more, as a matter of fact.

Q. You have testified that you acquired the stock or had [36] contracts to acquire the stock, that you entered into the employment agreement. Who were the board of directors of the Mission Bell following December 4, 1941, when you entered into this employment contract?

A. There was Mr. Douglas, Mr. Davidge and myself.

Q. You were the only three?

A. Yes, sir, that is right.

Q. Did Davidge and Douglas continue on the board of directors through 1941?

A. Yes, or their appointees. Both of the men went into the service at various times, and in Mr. Douglas' case, his wife was given power of attorney and she acted for him, and in Mr. Davidge's case, he appointed an attorney to act for him, when he went in the service.

Q. Well, then, am I correct in saying that either Davidge or Douglas continued on the board of directors through 1941 or down to 1943, inclusive?

(Testimony of H. Leslie Hoffman.)

A. Yes, sir.

Q. Either they or their nominees?

A. Yes, sir, that is right.

Q. Were either they or their nominees present at all board of directors meetings?

A. Yes, sir.

Q. During the years 1941, 1942 and 1943?

A. Yes, sir. [37]

Q. What was the condition of the physical assets inventory of Mission Bell when you took it over in December 1941?

A. Well, it was like Fibber Magee's closet, it had a little bit of everything in it, and in order to be brief, there were less than 100 completed chassis, the rest of the—there were approximately, as I recall it, some 25 completed sets. The rest of it was an accumulation of odds and ends, as far as the inventory was concerned, most of it partially complete or practically enough of the component parts to complete, test equipment, which of course is an essential item in the radio business was old and some of it was useful and some of it was not. They had some rivet machines and one screened booth. That was about the extent of their equipment. They had three soldering irons, as I remember it, in the factory.

Q. You became the President and General Manager of Mission Bell in December of 1941, is that correct?

A. That is right.

Q. Did you find any contracts that the corporation had with other people, either for sales commission or employment contracts?

(Testimony of H. Leslie Hoffman.)

A. Yes, I did. As a matter of fact, that was one of the previous people's weaknesses. They made contracts with quite a few people. They had a contract, number 1, they had [38] a contract with a chap by the name of Hamilton to sell radios to National Union Tube Company in the east and Sears Roebuck in the east on a three percent basis, with a guarantee that this—on the basis he would guarantee \$100,000 a year business.

Q. In other words, this sales agent was to receive three percent of the sales?

A. Yes, sir.

Q. Gross sales?

A. Yes, sir, that is, in that particular area, that is outside of the 11 western states and to these two companies.

Q. What did you do, if anything, with that contract? A. Cancelled it.

Q. Did you find any other contracts?

A. Yes, sir, I found—well, of course, Mr. Fleming had a contract on a percentage basis, the previous president.

Q. What was the basis of his percentage contract?

A. Well, as I recall it, it was on a different basis at different times, but the one that we cancelled at that time was around a five percent contract.

Q. Five percent of the sales?

A. Yes, sir, that is right, based on the sales. Mr. Fleming had had some contracts with the Police Department and things like that, and he was trying to develop some business there. [39]

(Testimony of H. Leslie Hoffman.)

Then they had another contract with a chap by the name of Taylor. Taylor was one of those government agents located in Washington, D. C., and his basis of compensation was five percent on any contracts that he developed for the company on military business, and I cancelled that.

Q. And his basis was what percent?

A. Five percent.

Q. Now, what services did you immediately concern yourself with in the beginning, in January of 1942, after you had gotten into this business?

A. Well, there were quite a few things, of course. The first thing was to find out what materials we had that were useable and whether we could not sell the non-useable equipment. Towards that end we took the inventory. I had already been given one and took a new one, and then took the residue of parts and put it on sale to sell the parts. And then the first thing to do was to get some engineering talent. I could handle everything else about the business, but I didn't have the technical knowledge to handle the engineering phase of it, and my first activity was to see if I could not work out the right kind of a deal with the right kind of a person to head up our engineering.

Q. Did you make an investigation to find out who could head up the engineering department?

A. Yes, I made quite a thorough investigation through [40] Mr. Fleming, who had been in the business for a long time. He told me of various people who would be available locally. One of them was a chap named Lou Brittain and I talked to him

(Testimony of H. Leslie Hoffman.)

and another chap whose name I don't recall at the moment, and then he told me about Mr. Harmon, who had been with the Mission Bell at one time and had left them at the time that Schmieter and Fleming had sold out their interest to the Warner crowd, because he didn't think it was a good move, which it subsequently proved not to be, and had gone over with a company called Mitchell-Hughes and evidently about that time he had left Mitchell-Hughes and was available, and so we sat down and discussed the possibilities of what could be done with the company, and evolved a contract.

Q. What was the basis of the contract that was evolved?

A. Well, I looked at that contract the same as I looked at my contract, that is, at that particular time the company had absolutely nothing, not even any prospects, I mean, we hadn't even any prospects of any business, and all we had was a lot of determination and nerve, so I felt, well—I felt that the desirable thing would be to give him some kind of participating incentive premium and to keep the actual stipend down as much as we could. I asked him how much it would take for him to live on, and we discussed a profit sharing program which he didn't want, and I rather concurred with him, and finally evolved on the basis of \$75.00 a week and one percent of the [41] gross sales.

Q. Did you engage the services of Mr. Harmon on that basis? A. Yes, sir.

Q. And he was employed by the company during the year 1942 on that basis? A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. Was he employed by the company during the year 1943 on that basis? A. Yes, sir.

Q. Was the employment of Mr. Harmon on the basis you have indicated discussed with Davidge and Douglas?

A. Very definitely. As a matter of fact, I had Mr. Harmon out to see Mr. Douglas and Mr. Davidge, and of course we went in town and met them, and as a matter of fact, one of his first questions was "Where are you going to get the financing to make the thing work?" So it was not only a matter of selling him but getting Douglas and Davidge's approval. We had to act all together on it.

Q. Did Davidge and Douglas approve of the contract you made with Harmon?

A. Very definitely, yes.

Q. There has been introduced, Mr. Hoffman, as stipulated Exhibit 2, the 1942 sales of the company, and as Exhibit 3 the 1943 sales of the company. I note that on Exhibit 2 [42] 1942 sales indicate commercial radio sales of \$122,799.03, is that correct?

A. Yes, sir.

Q. As contrasted with the total sales of Mission Bell for the year 1941 of \$29,000?

A. Yes, sir, that is right.

Q. And now, there are other contracts which you obtained which show that the total sales of the company for the year 1942 were \$351,950.62. Will you explain the sales other than commercial radio sales, and how the company obtained those contracts, if they were pursuant to contracts, and who performed that service?

(Testimony of H. Leslie Hoffman.)

A. You mean these contracts here, Judge?

Q. All other sales except commercial radio sales.

A. All right. Well, to begin with, well, we had discussed this program prior to Pearl Harbor, not after that, but prior to Pearl Harbor. By the time that we got squared around and ready to do something, of course, Pearl Harbor made us stop and think about what we were going to do, other than commercial radio, and then there were rumors of cutting back production, and things of that kind, and not having any organization of any kind to think of, the first thing we had to do was to get an organization, and of course, this ties in with commercial sales too, and we effected the purchase of the Mitchell Hughes Company's inventory of radio parts, and along with that inventory [43] of radio parts, why, we did acquire a certain small group of people that had been working under Mr. Harmon's jurisdiction building radios, so we moved the Mission Bell, when their rent was behind at Venice Boulevard, why, we paid that up and moved out of the place at Venice Boulevard and moved over to this little place on Broadway Place of some 7,500 square feet and put everything in there. Then we started looking around to see what kind of business we could get, and it was rather a tough job to sell, because Mission Bell, everybody had heard of Mission Bell's financial difficulties. And so we felt that the first thing to do was to go after sub-contract business of one kind or another, so we got a list from the War

(Testimony of H. Leslie Hoffman.)

Production Board of the various people who had prime contracts and I went around——

Q. May I interrupt you a moment there. Was there any further governmental order with respect to the prohibition of the manufacture and sale of radio sets? A. Yes, there was.

Q. During the war. When was that?

A. Frankly I have forgotten exactly what month it was. It was effective the early part of 1942, but it had come out prior to that time, at about February or March, I just don't recall.

Q. Well, if you had continued along the manufacture of commercial radio sets, is it true that this order would have [44] prohibited the continuance of that business, or would you have been able to manufacture still?

A. Well, of course, we could not have built any more radios, because the Government by the L-44-a order absolutely eliminated the manufacture of purely entertainment receivers.

Q. But you were permitted to sell radios that you had already manufactured, is that true?

A. That is right. The order provided that you could complete the receiver if you had the chassis 80 percent complete as of a definite date, and as a matter of fact, as reflected in our picture here, we had some cabinets come in in May and June, and we merely installed the chassis in the cabinets. But to go back to your other question relative to getting other business, I took this list of prime contractors and I went around and worked on it,

(Testimony of H. Leslie Hoffman.)

and I generated a lead over at Bendix Aviation in North Hollywood. Fortunately there was a machine shop, and my first work was to get some small stampings for this machine job, and by helping them and getting them in a hurry, I got acquainted over there. I didn't know anybody prior to the time I got acquainted over there. And they had a problem on a variable condenser which had to be used in what subsequently became known as the Gibson Girl, which was a rescue transmitter that was put aboard aircraft and if the boys were grounded they had this transmitter they put between their legs and cranked it, and it emitted an S.O.S. signal, and they [45] located them that way. The Army had stipulated a tuning condenser that no manufacturer was making and they didn't know where they were going to get it made, and I said I would like to take a shot at it. Well, we had never built variables and didn't know anything about it, but Harmon and one of the boys and myself worked this thing out. We had one lathe in the back of this Mitchell-Hughes Company, and we turned the shafts on the lathe and cut the plates out with tin-snips and made a fairly presentable unit and submitted that as a sample, and fortunately it worked, and fortunately although there were two or three other bidders, we were low in price, so we got a small order for this variable condenser. We immediately ran head on into some very strange problems in that. The way variable condensers are normally assembled, you have the shaft and you have

(Testimony of H. Leslie Hoffman.)

your rotor plates and your stator plates, and they are normally assembled mechanically, but to withstand the vibration of the unit they decided that they had to be soldered in, and Harmon and some of the boys developed a special jig with a head on the iron like that, we actually didn't solder them all in one soldering operation, and that worked out fairly well. As a matter of fact, we continued to be the sole supplier for that particular component right on through the war.

Q. Well, you got then these sub-contracts as well as prime contracts, is that correct? [46]

A. Well, my whole theory in this operation was that we had to start from a standing stop. In the first place, we had outside of Harmon, no engineer. We had no one in the organization of any consequence that knew anything about any of these special things, and in order to get these things to make we had to take what no one else would take, and that was really true all the way through.

Our next job was also with Bendix, and with this same piece of equipment that I mentioned. We had the problem of making this signal stronger. In other words, we had to devise some kind of antenna.

The ordinary fish-pole antenna like an automobile antenna would not be adequate. In talking about it somebody suggested the use of a kite. Mr. Harmon and the boys started out to build a kite, and they decided it had to be made from some component, from some material that had to be strong and light weight, and they got in touch with a com-

(Testimony of H. Leslie Hoffman.)

pany by the name of James Head Company of Dowagiac, Michigan which builds fish poles, metal fish poles, and they sent for some material, and on a Wednesday morning, I recall it quite vividly, they had called us up and wanted 100 of these kites built by Sunday, they had to make a C.F.E.A. shipment, and we went over and they gave us a handful of those rods and a handful of the cloth and gave us a rough print, just one print, and they said go ahead and build it. I stayed at the plant from Monday morning until Sunday night without any sleep and [47] Harmon did about the same thing, and between Harmon and myself and two or three other boys we got the 100 kites out, and subsequently, due to that performance and the fact that we had worked out, in the production of these kites, we had found out a lot of things about them that we could improve on the original design, we subsequently got an order from Bendix for that particular material, and also we continued to be not only—not the sole supplier but one of the suppliers on kites for the balance of the war.

Now, we followed through on that again. We had to go after things that were fairly simple to start out with. I went back east in June of 1942, and while there I finally struck up one contract for the development of an interphone amplifier, which they wanted developed and twelve samples built within a period of 45 days, and I guess they thought we were kind of foolish when we said we could do it, but I took it that day and I flew back to Dayton

(Testimony of H. Leslie Hoffman.)

with the twelve samples 45 days later, and I will never forget it because it was about 101 in that stockade and so I had to carry it all the way from the road up to the lab. But anyway, that shows on this sheet, but it doesn't show the volume. The dollar volume of the job was actually \$1,400. It shows here \$178, and that is what we actually made on it. Due to some strange quirk of bookkeeping they put the residue, what we made on it as the entry rather than the actual value of the product itself. That was what we [48] made on it actually, \$178.

Q. Mr. Hoffman, I intend to cover with another witness the intricate details of those things that you manufactured during 1942 and 1943. Would you tell the court who secured the contracts?

A. Who secured them? Would you like for me to go into detail about that?

Q. Yes.

A. Well, as I say, first I went to San Francisco—

Q. Try to be specific as to dates, if you can.

A. I went to San Francisco in March of 1942 and visited the Signal Corps up there. At that time that was headquarters for the Pacific Coast, and of course they asked me to fill out an application, about how many men we had and how large a place we had and all this and that, which I did, and they said they didn't have any authority to issue any contracts, so then they suggested that I contact Dayton, Monmouth, Philadelphia and Washington—those were the four procurement offices of the

(Testimony of H. Leslie Hoffman.)

Signal Corps at that time—which I proceeded to do, as I say in June. In June I went to Dayton, from the aircraft radio lab over to the Dayton Procurement District and again filled out questionnaires, and I took along some samples of our variable condenser and our kite, and my approach in practically all cases was that we didn't have too much in facilities but we had a lot of nerve and a lot of desire to do [49] something, and all the way along I met a great deal of resistance for the simple reason that, number 1, they felt that we were an invasion zone out here on the west coast, as a matter of fact, in one of my trips, I think it was that one in June, was about the time we had the scare out here of enemy aircraft over Los Angeles and all the ack-ack guns went off and so forth, so that was very much against us. They didn't want to do anything out here, they wanted to chiefly use labor to furnish new aircraft and ships. And number 2, they had some mistaken idea that technical brains stopped when you went across the Mississippi River, I think primarily due to the fact that all the people practically in these procurement districts were middlewest or eastern people. Then another contributing factor was the fact that the people who had to take action didn't use their heads very well and instead of working together they condemned one another rather than take the action, and so forth and so on. So all in all, it was not too easy. At that particular time, as it developed later on, the services were not so much interested in get-

(Testimony of H. Leslie Hoffman.)

ting manufacturers to build complete units as they were in getting someone to built the bits and pieces that made up the complete unit. In other words, their bottle-neck all through the war was the people who built these component parts, it was not particularly the people who built the complete parts, and so realizing that, after I got back in town we got together—then I went on to [50] Washington and went up to the War Production Board and covered all the various places, and about every place I went they said, “we will let you know if there is anything,” and so forth and so on.

The Court: We usually take a recess in the middle of the forenoon. We will be recessed at this time for ten minutes.

(Short recess taken.)

The Court: Proceed.

By Mr. Milliken:

Q. Mr. Hoffman, for the years 1942 and 1943, on your war work, either as a prime contractor or a sub-contractor, were you required to make a dead payment report to the Government Contract Renegotiation Board? A. Yes, sir, we were.

Q. I show you reports for 1942, 1943 and 1944. Did you prepare those? A. Yes, sir, I did.

Mr. Milliken: I should like to offer in evidence at this time, to shorten the testimony, your Honor, and show the contribution to the war effort and what work this corporation did during the year 1942 and 1943, the reports submitted to the Contract Renegotiation Board. I have in mind, besides

(Testimony of H. Leslie Hoffman.)

the materiality of this evidence, that several opinions of the Tax Court emphasized the contractor's contribution during [51] the years that are in question. In other words, whether or not you were a mere assembler of parts or whether you have contributed to the war effort by inventions, or what the nature of your work has been, and it would seem to me that I could shorten the testimony of the witness with respect to what was done if I offer in evidence the report filed with another government agency contemporaneously.

Mr. Crouter: If your Honor please, counsel offered me these reports this forenoon and I have had not opportunity to inspect them. While there may be things I want to go into on cross examination, I have no objection, if the Court please, to the 1942 reports and I have no objection to the 1943 report. I do object to the 1944 report for various reasons. It is wholly subsequent to our year. It comes and mixes up matters for several of the years. It would not present any kind of a definite or clear picture to the Court or to counsel for briefing purposes as to what happened in 1943, and I think it has no place in the case, it is immaterial and irrelevant, and will not show anything that happened during the taxable year.

Mr. Milliken: May it please the Court, with respect to 1944, I merely sought to introduce that for the purpose that there is an overlap in all of these years, and I would also introduce the orders received by this company during 1942 and 1943, and

(Testimony of H. Leslie Hoffman.)

therefore they can be related to the specific [52] renegotiation report.

Mr. Crouter: I would like to object further on the ground that the 1944 report includes many other things not of the character included in 1943, and it is self-serving, and from various sources, and there are facts in that which are very self-serving and hearsay to a very extreme degree.

Mr. Milliken: I think that goes to the materiality, your Honor, and that if counsel thinks they are self-serving, then he has the privilege of cross examination.

The Court: I will admit the 1942 and 1943 reports at this time and we will see as we go along—you may offer the 1944 later. I think perhaps you can do it later in the trial.

The Clerk: Exhibits 1 and 2.

The Court: Exhibit 1 will be the 1942 report, I take it?

Mr. Milliken: Yes.

The Court: Admitted as Petitioner's Exhibit No. 1, 1943 as Petitioner's Exhibit No. 2.

(The documents above-referred to were received in evidence and marked Petitioner's Exhibits Nos. 1 and 2.)

[Printer's Note]: Petitioner's Exhibits 1 and 2 are out in full at pages 346 to 390 of this printed Record.

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: I might call counsel's attention to the fact that we go through No. 22, I believe, in the exhibits to the stipulation. We have followed the order designated by the court rules, having given the Petitioner's exhibits numbers and the Respondent's exhibits letters, I believe, if that will [53] make any difference in this.

The Court: Well, we sometimes follow through there, but you have a considerable number of exhibits to the stipulation and I think we will start again with our numbers. There should be no confusion in that.

Mr. Crouter: I just wanted to bring that out.

The Clerk: Exhibits 1 and 2.

By Mr. Milliken:

Q. Mr. Hoffman, did you make a list of the orders received in the year 1942 by the petitioner?

A. Yes.

Q. Does the paper I hand you reflect the orders received in 1942? A. Yes, I believe it does.

Mr. Milliken: I should like to introduce that in evidence as Petitioner's exhibit next in order.

The Court: Now, these are what?

Mr. Milliken: These are just the orders, the numbers of them.

The Court: What kind of orders?

Mr. Milliken: Orders for production on prime contracts and sub-contracts.

(Testimony of H. Leslie Hoffman.)

The Court: I don't know what you mean by orders, orders from the government, or are these orders from the company for supplies?

Mr. Milliken: That is correct, your Honor. [54]

Mr. Crouter: Do I understand this is the business of the Petitioner?

Mr. Milliken: Orders received by petitioner in the year 1942 related to sub-contracts or prime contract orders.

Mr. Crouter: I object on the ground that it is wholly inconsistent with our stipulation. It starts with Bendix Aviation and is limited to the amounts, but that was what we intended when we stipulated. They appear to relate to a great many other things besides the petitioner's business.

Mr. Milliken: No, I think you are confused, Mr. Crouter. Our stipulation relates to the amount of money received. Orders may have been received for a million dollars in the year but the actual money received in the year might be fifty thousand.

Mr. Crouter: May I examine the witness on the document, then?

Mr. Milliken: Yes.

Mr. Crouter: Is that permissible?

The Court: Yes, go ahead.

By Mr. Crouter:

Q. Mr. Hoffman, I just want to check on the first exhibit which is there and headed 1942 orders summary.

A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. You will observe on the Exhibit 2 in the case, a copy of which you have before you, it shows that you had signed contracts with Bendix Aviation and the total amount shown for the [55] year was \$209,018.08.

A. Yes, sir.

Q. Are some of those orders included in this exhibit that is offered here?

A. Yes, I should say, sir, this is the date we received the order.

Q. You say "this." What do you mean?

A. This date here, for instance, this is their order number 5703-R.

Q. Is that the Bendix order number?

A. Yes, sir. That is the Bendix Aviation, that is their order number and this is the date of their order.

Q. Is that the order between Bendix and the government?

A. No, between Bendix and Hoffman Radio, or Mission Bell at that time.

Q. I see, and this is the quantity of units ordered in the order and this is the date, as I understand it, of that particular order. Does that all relate to contractual arrangements then between the Hoffman Corporation and Bendix?

A. Yes, sir.

Q. And these were orders that were placed during the period indicated here?

A. Yes, sir. We go right on down here in this fashion (indicating) and then we go to the right here and this is a \$1400 item.

(Testimony of H. Leslie Hoffman.)

Q. How long did it take to complete those orders? [56]

A. Well, some of those orders went on into 1943. Of course, when these orders here—now, you see this order here, this frequency meter order I secured on December 5th, which was the result of a lot of work back there and we actually did not start producing on it until July and August of 1943, because of the intricate amount of tooling and preparation to actually produce it, the engineering involved.

Q. Do I understand, then, that your corporation took these orders and did work on them to subsequent dates from the date of the order?

A. Yes, sir.

Q. How long do they carry through? 1943, don't they?

A. Some of them do. I don't think that I know, to be specific. I am quite sure that all of these orders completed are on it.

Q. Referring to the last column?

A. Yes, here, that was completed in 1943. I don't think those dates are here.

Q. You are referring to that item there for 3,000,000 plus? A. Yes, sir.

Q. That was dated December 5, 1942?

A. Yes, sir, that is right.

Q. Are those posted from your records on contracts you [57] definitely had with Bendix, I understand, on your books and recorded?

A. Those are taken directly from the orders.

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: I withdraw the objection.

Mr. Milliken: I will introduce the 1942 entitled "Order Summary" as Petitioner's Exhibit next in order.

The Court: Petitioner's Exhibit No. 3 is admitted in evidence, being the instrument just referred to by counsel.

(The document referred to was received in evidence and marked Petitioner's Exhibit No. 3.)

[Printer's Note]: Petitioner's Exhibit No. 3 is set out in full at page 391 of this printed Record.

Q. (By Mr. Milliken): Did you prepare a similar summary with respect to 1943 orders?

A. Yes, sir.

Mr. Milliken: I offer the same exhibit with respect to the year 1943.

Q. (By Mr. Milliken): And that was compiled upon the same basis as your prior testimony was concerning the year 1942?

A. Yes, sir, it was taken directly from the orders received.

Mr. Crouter: No objection.

The Clerk: No. 4.

The Court: Let the instrument just identified by the witness be admitted as Petitioner's Exhibit No. 4. [58]

(Testimony of H. Leslie Hoffman.)

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 4.)

[Printer's Note]: Petitioner's Exhibit No. 4 is set out in full at page 392 of this printed Record.

By Mr. Milliken:

Q. During the year 1943, who was the president of this Petitioner? A. I was president.

Q. Who was the general manager?

A. I was.

Q. Did you have an advertising manager?

A. No, sir. I handled the advertising, what there was of it.

Q. Did you have a sales manager?

A. No, sir, I handled all the sales.

Q. Did the Petitioner in the year 1943 have any commission contracts with any one except yourself and Mr. Harmon? A. No, sir.

Q. Who was in charge of the personnel?

A. I handled personnel. I handled it through my secretary. Actually the way we handled personnel was that my secretary did some of the detail work and then we had an employment-management group made up of representatives from various groups, and I sat with these people twice a week and we cleared up various personnel problems at that time.

Q. Did you have a public relations manager in 1943? A. No, sir. I handled that. [59]

Q. A production manager?

(Testimony of H. Leslie Hoffman.)

A. Well, I handled—I had charge of all the production, that is I headed all that up. Although we had an actual production manager, he reported directly to me and I coordinated the whole thing.

Q. Was it customary in the year 1943 in your industry to have a Washington representative?

A. Yes, it was. Practically all companies had them.

Q. Did your company have one?

A. No, sir.

Q. What was the basis of employment in the industry in the year 1943 of Washington representatives, if you know?

A. Well, that varied a great deal. One definite case I know of that could be related, companies like the Petitioner, is the case of Taylor, who operated on a 5 per cent basis and whose contract we cancelled. I do happen to know it to be a fact that Taylor had a 5 per cent contract with some other local companies which he was doing.

Q. That is 5 per cent if he made a contract with the government, he was to get 5 per cent of the total amount represented by the contract?

A. Yes, sir, that is right.

Q. Was your corporation given any—

The Court: I want to ask right there, would that be 5 per cent of the total amount received under the contract, [60] or—of the actual amount received under the contract, which I can see how it might be more or less finally than the contract called for?

(Testimony of H. Leslie Hoffman.)

The Witness: It would be based on what was received, your Honor.

The Court: Go ahead.

Q. (By Mr. Milliken): Did your corporation receive any commendation from the armed forces on your work during the year 1943?

A. We did not receive—well, we received a great deal of commendation verbally, but I know we were recommended in 1943 for the Army-Navy E which we received subsequently in 1944. We were the only company on the West Coast to receive an Army-Navy E from the Navy.

Q. Were all of your contracts, either sub-contracts or prime contracts, related to the war effort, were they on a competitive bid basis?

A. Yes, they were, very much so. As a matter of fact, as I explained before recess, we had a great deal of difficulty in getting contracts, and the only contracts we had a chance to bid on were those that major companies in the east could not handle, and on those we had to be a low bidder to get the contract.

Q. Did you receive any cost-plus contracts from the government during the year 1943? [61]

A. No, sir, we did not. We had one contract with the Office of Scientific Research & Development, which is called OSRD, which was a rather intricate job and was tied in with Caltech, and we had——

Q. That is California Institute of Technology?

A. California Institute of Technology, and we had their engineers tied up on that job. It was a

(Testimony of H. Leslie Hoffman.)

very intricate job, and that was for—we contracted to perform certain work for a certain amount of money.

Q. How much was that contract in dollars and cents?

A. As I recall it, it was around two hundred thousand dollars.

Q. What year was that?

A. It was in 1943, and it was also carried into 1944.

Q. Was your company the subject of re-negotiation for excessive profits during the year 1943? A. Yes, sir.

Q. What was the result of your re-negotiation determination?

A. Well, the result was that, number one, they gave consideration to the fact that we had remitted to the services over a hundred thousand dollars voluntarily and——

Q. What do you mean that you had remitted voluntarily a hundred thousand?

A. Well, we had voluntarily reduced the prices of [62] certain articles we were manufacturing and gave them a check for the difference, making it retroactive for the units that we had built.

Q. In other words, do I understand you that you refunded a hundred thousand dollars to the government? A. Yes, sir.

Q. Even though you had a competitive contract?

A. Yes, sir, that is right. As a matter of fact, on one particular contract which amounted orig-

(Testimony of H. Leslie Hoffman.)

inally to around four million we remitted about over a million, subsequently.

Q. Did you set forth to the re-negotiating board in 1943 the compensation which the corporation had paid to you and Harmon? A. Yes, sir.

Q. In the amounts of \$63,000.00 round figures to you and \$22,000.00 to Harmon?

A. Yes, sir.

Q. In the year 1943? A. Yes, sir.

Q. Did the contract readjustment board object to those items of cost? A. No, sir.

Mr. Crouter: If your Honor please, I object to that, in that it is not shown here, this will probably be calling for pure hearsay. It is if the witness is not produced here. [63]

Q. (By Mr. Milliken): Did you handle the re-negotiation? A. Yes, sir.

Q. Did you finally agree as to the amount you should pay incident to re-negotiation?

A. Yes, sir.

Q. Were you familiar with all of the items and costs of your business allowed or disallowed in the year 1943? A. Yes, I was.

Q. Did they allow or disallow as an element of cost yours or Harmon's salary?

A. They allowed it.

Q. They allowed it? A. Yes, sir.

The Court: Let me ask a question here. I don't want to bother you too much, Mr. Milliken, but those contracts upon which revisions were made that you spoke of, one of a hundred thousand and

(Testimony of H. Leslie Hoffman.)

one of about a million, were those contracts made, do you know, before or after April 28, 1942?

The Witness: They were made before or after April 28, 1942?

The Court: Yes.

The Witness: Those contracts were made after April 28, 1942. [64]

The Court: Go ahead.

Q. (By Mr. Milliken): Did your corporation have any dealings with the Salaries Stabilization Unit of the Bureau of Internal Revenue with respect to the year 1943? A. Yes, sir.

Q. Did you submit your contract as well as the terms of the contract with Harmon to the Salaries Stabilization Unit? A. Yes, sir.

Q. Did they approve or disapprove of the salaries?

Mr. Crouter: If your Honor please, I object to that. If it is material, I believe that it should be placed in evidence by the Salaries Stabilization Committee. Personally I have seen nothing of that, I know nothing of it, and I should imagine that you could get a written statement.

Mr. Milliken: We will offer the original letter from them approving it, if counsel desires.

Mr. Crouter: And also the statements submitted in the application?

Mr. Milliken: Yes.

Mr. Crouter: With respect to these salaries.

Mr. Milliken: All the correspondence that you desire.

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: Then I move that the last question [65] and answer be stricken on the ground that it is not the best evidence.

The Court: We will strike the last question and answer.

Mr. Milliken: We will come back to that.

Q. (By Mr. Milliken): Can you estimate for the Court the number of hours that you worked during the year 1943 for this corporation, on an hourly basis?

A. I would say that it would average between fourteen and sixteen hours a day.

Q. Did you organize or did you have any relation to the electronics industry that was organized on the Pacific Coast?

A. Yes. One of the main problems in securing contracts for not only our company but other contractors in this area for the items we have produced and other places have, that we were in a number one labor area here, and the contractors of both the Army and the Navy, or the official contractors had notified their contracting officers not to place contracts in a number one labor area. We had that problem, and I was instrumental in getting the various people together here dealing in electronic equipment, both in the Los Angeles area and in the San Francisco area, to form an association called West Coast Electronic Manufacturers Association, of which I was elected president, and we got together vital statistics [66] showing for one, the location of the plants, the facilities of the plants, the labor supply, the know-how they had

(Testimony of H. Leslie Hoffman.)

in these respective plants, and at that time as I say we were having great difficulty, everyone was having difficulty getting contracts out here. Some of the large ones, like Gilfillan, and Packard Bell, were fairly well off, but some of the smaller ones were not doing so well, including ourselves, and we got this together and I took that together with some other information back to Washington and covered it for the entire area, and the result of that was that in 1944—one of the biggest things we had to develop was suppliers for component parts, and in 1944 they produced electronic equipment at the rate here on the Coast of two hundred and fifty million dollars a year, which was ten or twelve times what we started out doing.

The Court: Counsel, in order that I may follow along, I would like the significance of a number one labor area.

Q. (By Mr. Milliken): Will you explain number one?

A. Yes, sir, your Honor. All the various sections of the country were classified by the War Man Power Commission in Washington, and they were number one, two, three and four labor areas. Number One was where there existed a critical shortage of labor, and the Man Power Commission got together [67] with the various services and agreed that they would not put contracts in those areas that showed a critical labor shortage.

The Court: That is sufficient, I think.

Q. (By Mr. Milliken): You stated that they had no Washington contact man representing this

(Testimony of H. Leslie Hoffman.)

corporation. Who did represent the corporation in Washington?

A. I represented the corporation. I got various contracts back there and we subsequently sent a man back to Washington to handle the contracts once the contracts were secured.

Q. Was it necessary for the corporation to secure any loans for the operation of its business during the year 1943? A. Yes, sir, it was.

Q. Did they secure such loans? A. Yes, sir.

Q. From whom?

A. In 1943 we secured it from the California Bank.

Q. Did the bank require any endorsement other than that of the corporation?

A. Yes, sir, they did.

Q. To guarantee those loans?

A. They required the endorsement of Douglas, Mr. Davidge and myself. [68]

Q. Did you so endorse the loan?

A. Yes, sir, we did.

Mr. Milliken: I believe that it is all, Mr. Crouter.

The Court: Did you borrow any from the government?

The Witness: No, sir.

Cross-Examination

By Mr. Crouter:

Q. Did you secure any loans at all, Mr. Hoffman, in 1942? A. Yes, sir, we did.

Q. I believe you testified just previously you received them in 1943?

(Testimony of H. Leslie Hoffman.)

A. I believe the answer was that we received government loans in 1943.

Q. In 1942 you also secured government loans?

A. No government loans. We had no government loans at any time.

Q. They were bank loans then?

A. They had a bank loan. Now, that word borrow and loan—there is a question of terminology on the borrowing and loan. The picture there is that you borrow directly from the bank and that the government guarantees 90 per cent of it.

Q. How much was your first loan?

A. Frankly I don't recall. [69]

Q. About how much?

A. It was around two hundred thousand.

Q. In 1942? A. Yes, sir.

Q. About how much was it in 1943?

A. Well, we had a loan of \$400,000.00 from the California Bank, and the nature of the contract that we secured in the latter part of 1942, this frequency meter, was such that it appeared that we would have to have to secure a loan of \$750,000.00, so subsequently, I believe it was the latter part of 1943, we transferred our loan from the California Bank to the Bank of America, due principally to the fact that the California Bank could not loan up to \$750,000.00 based on a government warranty on their capital and so forth. So that to answer your question specifically, we had a loan the latter part of 1943 for \$400,000.00, which we didn't use, but that was the total of it, and the latter part of 1943, \$750,000.00.

(Testimony of H. Leslie Hoffman.)

Q. You mean you actually made a loan for that much or was it merely authorized?

A. It was authorized.

Q. How much did you actually secure from the Bank of America? What is the total amount in 1943?

A. I would have to guess at that, sir. I would guess——

Mr. Milliken: I don't believe—I don't mean to [70] interrupt—that he said the Bank of America in 1943. I understood you to say you spoke to them in 1943.

The Witness: We made arrangements to—I would have to check the records to give an accurate answer.

Q. (By Mr. Crouter): You did borrow at least four or five hundred thousand dollars in 1943, did you not? A. I would say that we did.

Q. And the banks in turn were backed up by the federal government to the extent of a very large percentage, possibly as much as 90 per cent of such loans, were they not? A. Yes.

Q. You know that that was backed up by federal money and guaranteed?

A. That is right.

Q. That is the way they did business?

A. That was the nature of the loan.

Q. I suppose that was necessary because you were undertaking large orders and commitments, and you had your cost factor and your labor factor, which were much beyond any regular financing that your company could have handled?

(Testimony of H. Leslie Hoffman.)

A. That is right. We were in the same position as 95 per cent of the other companies.

Mr. Crouter: May I see the last exhibits offered, particularly the re-negotiation reports. [71]

The Clerk: Three and four. Do you want this too?

Mr. Crouter: Yes, please. Thank you.

Q. (By Mr. Crouter): Before going into this, Mr. Hoffman, I would like to ask you a few questions regarding some of the early background that you stated here. You don't mind telling the Court how old you are right now, do you?

A. No, sir. 42.

Q. 42. What course, if any, did you specialize in in the Albion, Michigan, college?

A. I had a major in both business administration and philosophy.

Q. Studied no engineering at all?

A. I took the normal science degrees of physics and chemistry and things of that sort.

Q. What degree did you receive there, if any?

A. I received a regular—

Q. Bachelor of Arts?

A. Bachelor of Arts degree.

The Court: I don't want to be confused on that. Perhaps the witness used the word degree when he meant studies. You said you received the regular physics and science degrees.

The Witness: I misstated that. I took the regular courses. That is right. [72]

(Testimony of H. Leslie Hoffman.)

Q. (By Mr. Crouter): There were certain prescribed courses such as math and science that you took?

A. There was a certain amount of science.

Q. And a language or two?

A. That is right. I was playing football. I had to have all my credits.

Q. What year was it you graduated?

A. 1928.

Q. 1928? A. Yes, sir.

Q. That is when you received your A.B. degree? A. Yes, sir, that is right.

Q. I know this will tax your memory a little bit, but let's go down through and tell the Court the best you can recall the, approximately, amount of weekly, monthly or annual compensation you received from these various firms that you testified to. First let us take the Sparton Radio Company there at Jackson. Do you remember at what you started as stock clerk?

A. Yes. I think I started at 50 cents an hour.

Q. 50 cents an hour? A. Yes, sir.

Q. Worked an 8-or 9-hour day or was it 10 in those days? [73]

A. Well, we worked 10 hours, then I went on and had a 12-hour shift.

Q. About how long were you there in 1928 on?

A. Now, let's see. I went there in June of 1928, when I got out of college, and I was there about eleven months.

(Testimony of H. Leslie Hoffman.)

Q. Of course you didn't have a great deal to do with stepping up of production there, you had no function then as stock clerk?

A. I most certainly did. I was not stock clerk at that time. I was line foreman at that time.

Q. What did you do as line foreman?

A. Well, I had about thirty girls on the line, I started out with thirty, I had to direct them and had to show them how to build the radios, I was building what is called the RF amplifier, I was the line foreman and all of the production on that particular line was under my jurisdiction. I was under the jurisdiction of the factory superintendent.

Q. What is the most you received there during that period?

A. Well, I think the most that I received there was probably sixty or seventy-five dollars a week, which was big money in those days, for my age.

Q. Was that just an assembly operation or did they actually manufacture some of the radio apparatus that went [74] into the final product?

A. Well, in those days, twenty years ago, the radio manufacturers manufactured more than they actually do now. As a matter of fact Sparton built their own tubes, they built their own coils, and they built most all of the parts that went into the sets. Of course, I grew up in the manufacturing business back in Michigan. I started in the factory when I was 13 years old, so I had more actual manufacturing savvy than the experience would indicate.

(Testimony of H. Leslie Hoffman.)

Q. What kind of horns was it you referred to that they manufactured?

A. Electric horns, automobile horns.

Q. Mostly automobile horns, horns for automobiles?

A. Have you heard the slogan, "Safety first, sound your Klaxon"? That was their slogan.

Q. When was it that you went to Reynolds Spring in Jackson?

A. I think in either April or May of 1929.

Q. What was the financial arrangement there?

A. As I recall, it was between 80 and 90 cents an hour, something like that. It was an hourly rate.

Q. As I recall, you said they manufactured lighting systems, stadium lights and things of that character?

A. Yes, plus the average molding devices, they made toggle plates for electrical outlets and things of that kind. [75]

Q. Did they have anything at all to do with radio manufacture or assembly?

A. No, sir, they did not, no, sir. Of course, I had charge of their machine shop. I had charge at the time I was there of the mechanics. That was very largely mold mechanics or assembly.

Q. I understood you stayed there for less than a year and came to California some time in the year 1929?

A. Yes, sir, that is right.

Q. What was the business of the Ellis-Bishop Company that you mentioned?

A. That was an investment house.

(Testimony of H. Leslie Hoffman.)

Q. Where were they located?

A. Pasadena.

Q. Just regular security investment?

A. Yes, sir, just investment.

Q. Counsellors and so forth?

A. Counsellors, salesmen.

Q. Did they have accounts with brokerage companies?

A. Yes, they were connected with Banks-Huntley Company here in Los Angeles.

Q. Banks-Huntley, a large concern downtown here?

A. Yes, sir. They were Pasadena agents for Banks-Huntley.

Q. You say it was only about 60 days you were with them? [76]

A. That is right.

Q. What was your compensation there?

A. One hundred dollars a month plus what I could sell.

Q. Then with the Broadway Department Store as a trainee, you were being trained as to some of their operations?

A. I was being trained for a buyer's position.

Q. How long did you stay there?

A. Oh, I didn't stay there very long. I stayed there about 90 days I think.

Q. Did you receive some compensation while you were in training?

A. Yes, sir, I think it was one hundred and twenty-five a month, I think something like that. It was very small.

(Testimony of H. Leslie Hoffman.)

Q. Then you left there early in 1930 and went with Firestone? A. Yes, sir.

Q. What was the location of the Firestone place?

A. 2525 Firestone Boulevard, South Gate, or Huntington Park, I believe it is.

Q. That is in the suburban area down south of Los Angeles proper? A. Yes, sir.

Q. About what, eight or ten miles down?

A. I would say it was eight miles. 85th Street.

Q. In relation to 85th Street South, that is about due south of the City of Los Angeles?

A. Yes.

Q. You went in there as clerk, you say, at what compensation?

A. I don't remember exactly, but it was very small, I know that.

Q. Let us have your best recollection?

A. I would say it was around a hundred and thirty dollars or so.

Q. Any commission?

A. No commission. Just straight salary.

Q. Straight salary? A. Yes, sir.

Q. And you continued there until what year?

A. I continued with Firestone at the factory there from 1930 to 1935, at which time I still stayed with Firestone but I went to Portland, Oregon.

Q. Well, you went with the Firestone at Portland? A. Yes, sir.

Q. And how far did you get in the way of compensation during that period when you were with

(Testimony of H. Leslie Hoffman.)

Firestone then? What is the top that you finally arrived at with Firestone?

A. Well, I think the top I arrived at was three hundred dollars a month. [78]

Q. Was that in this area or around Portland?

A. It was this area and Portland, and of course in Portland on the company's program in the stores I had a certain percentage of the profits.

Q. Then that was three hundred dollars a month, and that was your total compensation up to about 1935?

A. Yes, sir, that is right.

Q. That is with Firestone?

A. That is right.

Q. With Firestone you, as I recall your testimony, handled a little bit of everything from tires to batteries and various automobile equipment and accessories, did you not?

A. Yes, sir, I handled the sales department of everything except truck tires and automobile tires. That was covering the eleven Western states. Of course, that was the middle of the depression, and I was not paid very much money those days.

Q. Was the place at 2525 Firestone Boulevard the head main manufacturing or production office of Firestone in this area?

A. The way they worked it they have two main offices, one in Akron, one in Los Angeles. Los Angeles manufactures tires here, and at the same time all of the sales in the eleven western states are under the Los Angeles jurisdiction. [79]

(Testimony of H. Leslie Hoffman.)

Q. Most of their real manufacturing of Firestone was actually done at the Akron plant, was it not?

A. No, sir, it was not. We built batteries out here and we built automobile tires and truck tires. We built mechanical rubber goods out here.

Q. I see. You were chiefly connected with the sales part of the business, were you not?

A. I had the sales, I had the scheduling to the factory, I had the training in the field, I had to set up the service departments, I had to start all the workers on those things.

Q. Just tell us from the time you went there until you left, various exact operations, I mean what you actually did to supervise?

A. I will be glad to, but it will take some time. If you want to take the time—

Q. For instance, I am referring to this one between 1932 and 1933 when you were over five different departments. Do you mean to tell the Court that you personally had charge of five different departments and you took them over?

A. Yes, sir, I mean to tell you that exactly.

Q. What were those departments?

A. In the first place, they had a man by the name of Captain Packham that had charge of aircraft tires, who had them manufacture twice as many aircraft tires as they would ever [80] be able to sell to airplanes, and so they let Captain Packham go and gave me the job of selling these aircraft tires, which I proceeded to do.

(Testimony of H. Leslie Hoffman.)

Q. You stated you were put in charge—

A. Do you want me to follow on with the rest of this?

Q. Yes, go ahead, if you haven't finished your answer. Tell us what title you held and what you actually received for it as best you recall.

A. Well, I was sales manager of the allied products division, that was my title, but I started—that was again a progressive field. I started out the first time, I became department head there, I had charge of battery sales. Then I became battery truck man and took over the truck line, before a chap by the name of Harold Keller had it, and then I became the allied products sales manager with all their other accessories, and a chap by the name of Norman Fawcett had it.

Q. Do you remember what your compensation was, so we get that part of it? A. Yes.

Q. What was it?

A. I was making two hundred and fifty dollars and I got a raise to two hundred and sixty dollars, two hundred and seventy dollars, and a 10 per cent raise came along in there some place. [81]

Q. That is from two hundred and fifty to two hundred and seventy per month? A. Yes.

Q. That you were getting in 1933?

A. Some where along in there, I have forgotten where it was, as a matter of fact they had two raises. I dodged one and got the other.

Q. Was it before or after that time you stated you were in charge of the oil company business for a period of time?

(Testimony of H. Leslie Hoffman.)

A. That was approximately 19——let me think a minute on that. That was the early part of 1943.

Q. 1943?

A. Yes, or 1933, I am sorry, because I was holding a sales meeting with the Union Oil people in Walla Walla, Washington, when the banks closed. I remember that.

Q. You mean the oil company business was selling accessories like tires at its stations, is that it?

A. Well, just to outline in detail, Firestone was interested in extending the distribution of their products, and we got the Union Oil Company interested in selling Firestone tires in all their stations, and we got that tire opening and then I developed this unit for merchandising batteries and spark plugs in these various stations, because it was a small, compact unit they could get into a small space, which [82] was required in a service station, and due to my development of that I was put in charge of the Union Oil account for a period of time as well as the Texas account. In those days we did a little bit of everything. It was not too highly specialized.

Q. Did the Firestone company at that time have various parts retail stores? A. Yes, sir.

Q. In different towns? A. Yes, sir.

Q. Did you have anything to do with them or was that something different?

A. Yes, of course, I had something to do with the one store when I went to Portland, and on the other stores, those stores again, it is a rather con-

(Testimony of H. Leslie Hoffman.)

fused picture, because part of the time those stores are under the district offices and part of the district offices were directly under our jurisdiction, and part of the time their stores answered to a store manager in the territory who was not in the sales department function, so part of the time we had something to do with those stores and part of the time we didn't have.

Q. That was just incidentally though, wasn't it?

A. No, it was not incidental. Just to give you a factual answer, I would go to Portland, Oregon, when I was working in that territory for the factory, and I would sit down and [83] have a sales meeting with the salesmen and check the sales, and then I would go with the salesmen and check on their accounts, or go and talk with some of the customers, and I would go to the stores and go to the battery department and check over what they were doing to get retail sales. It was part of my duties when I was in the field to see what I could do to help out those retail stores.

Q. Referring to this statement, the total sales of all these departments were about four hundred or five hundred thousand dollars, I believe you referred to the five different departments?

A. Yes, that is it.

Q. What area did that refer to?

A. Elevent western states.

Q. Do you mean to say you had supervision over all of them?

A. Yes, sir.

Q. So that that was the result of your work there?

A. That is right.

(Testimony of H. Leslie Hoffman.)

Q. And then I believe, referring to your testimony, that some time during the next eighteen months you took in roughly three to three and a half million dollars?

A. That referred to those departments that I have enumerated.

Q. You mean those same branches or departments? [84]

A. That is right.

Q. And you mean that was all under your jurisdiction?

A. That is right.

Q. What was your title then when you took in the three and a half million dollars you referred to?

A. That was at the time I had the title of manager of the allied products department.

Q. How many stores did you have up and down the coast that the three and a half million would come from?

A. It was not entirely stores. It was Firestone dealers as well as stores. For instance on mechanical rubber goods I developed a deal, just to give you a side glance at it, I developed a mechanical gun which sold and we developed a little demand for it, and then I developed five hundred and fourteen new retread outlets for retread material.

Q. Was that the position you held until you went to Portland?

A. Yes, sir, that is right.

Q. Then you went to Portland as manager of a store up there?

A. As store manager, yes, sir.

Q. That was in 1935?

A. Yes, sir, that is right.

(Testimony of H. Leslie Hoffman.)

Q. What was your compensation there?

A. I kept the same salary I had at the factory.

Q. And that was what?

A. As I recall, it was around two hundred and seventy or two hundred and eighty dollars, something like that up there.

Q. Any commission or bonus?

A. We had a bonus, yes, in the store.

Q. What per cent bonus?

A. We had a 10 per cent bonus, 10 per cent of the profits.

Q. 10 per cent of the net profits of your store?

A. Yes, sir, that is right.

Q. Do you remember about your total compensation you made we will say beginning 1935, what amount of commission you got out of the store at Portland?

A. Well, I think my compensation that year was around thirty-eight hundred dollars.

Q. Let's take the next year. You were still with the Firestone in Portland in August, 1936?

A. Yes, up until the last three or four months of 1936.

Q. In the same position? A. Yes.

Q. And compensation about the same?

A. Yes, sir, except that I didn't have the last three or four months' income.

Q. In 1937, when you were with the Electrical Distributing Company in Portland, what was your compensation there? [86]

A. My compensation was about the same amount, I think around two hundred and seventy-

(Testimony of H. Leslie Hoffman.)

five dollars, but I was supposed to have a bonus program on the sales which did not materialize.

Q. Never received any bonus?

A. A very small one.

Q. How long did you remain there?

A. Just a year.

Q. One year? A. Yes, sir.

Q. Was that mostly work in and around Portland or did you do some driving?

A. No, sir, I was doing driving as well.

Q. Oregon and other places?

A. I beg pardon.

Q. Oregon and Washington and other territory?

A. It was just the State of Oregon.

Q. Oregon alone? A. Yes, sir.

Q. Then was it 1938 that you first went with this Lumidor company? A. No, sir, 1939.

Q. How long did you stay with the Electrical Distributing?

A. I was there during the year 1937. [87]

Q. What did you do in 1938?

A. I had a try at starting a manufacturers' representative business of my own. I sold various lines, as I mentioned before, washing machines and refrigerators, lamps, a little bit of everything.

Q. Anything but radios?

A. Yes, I had a radio line.

Q. They were other lines that you had worked previously in and you were just selling on a commission basis?

(Testimony of H. Leslie Hoffman.)

A. Yes, sir, I was selling on a commission basis. Then also I was secretary of the oil heater association here in town, which has a program of developing oil heater sales here.

Q. As I understand, in 1939 you went into the Lumidor company?

A. In 1939, yes, I handled the sales for Lumidor, and I interested them in the manufacture of this fluorescent table lamp to start out with, and then I branched out from that into other things.

Q. What was the full name of the Lumidor company?

A. Lumidor Manufacturing Company.

Q. Where was that located?

A. Located on Marengo Street, Alhambra.

Q. A little city up northeast of Los Angeles proper?

A. Yes, that is right. [88]

Q. Just on the edge of the city limits?

A. That is right.

Q. And is this lamp that the Lumidor Manufacturing Company produced there, is that something that you patented or invented or what was it?

A. No, it was not anything I patented. In the first place, Lumidor was manufacturing floor lamps for the Edison Company, and they had the facilities to build the lamps, and I took this lamp that I was selling from the east and told the manager of the Lumidor what I thought it should be like, and we sat down and worked out a design of a lamp, and then I went out and sold it.

Q. You had the idea that they developed and produced?

A. I beg pardon.

(Testimony of H. Leslie Hoffman.)

Q. They developed and manufactured.

A. It was not exclusively my own idea. It was a combination of their ideas and my ideas. In other words, I had an idea of what I wanted functionally and they had an idea how to best produce it, so we got our ideas together.

Q. What was your compensation at the Lumidor company?

A. 10 per cent sales commission.

Q. Do you remember about what you got in 1939 or 1940, whatever it was?

A. 1940 I made around forty-seven hundred dollars, as I recall it, or a little over. [89]

Q. In 1939 can you tell about what you made?

A. 1939 we were just getting started, and as I recall it was around nineteen hundred or something like that.

Q. Then when was it that you left Lumidor?

A. I left Lumidor the latter part of 1940 I believe.

Q. What was the highest position and the highest compensation you received from Lumidor?

A. Well, speaking of positions, I was given the title of sales manager of the Fluorescent products. Actually I was the sales manager and the sales force, and as far as compensation, I believe I covered that previously.

Q. Well, let's carry it forward from 1940. Did you still continue with Lumidor in 1941?

A. No, not that I recall.

Q. You were with the Peerless company, wasn't it?

(Testimony of H. Leslie Hoffman.)

A. Yes, sir, Peerless Electrical Manufacturing Company.

Q. What did you actually do there?

A. Well, there again I was the sales manager and the sales force and everything else.

Q. What was their business?

A. They were manufacturers of transformers.

Q. What do you mean, radio?

A. Radio transformers, that is radio sound transformers.

Q. What was your compensation basis there?

A. 10 per cent commission. [90]

Q. How well did that turn out?

A. It turned out very well.

Q. About how much?

A. Well, my income was thirteen thousand dollars in 1941?

Q. 1941? A. Yes, sir.

Q. I just wanted to check on something here. Are you talking about the total amount?

A. I am talking about my gross income.

Q. I see. That does check with your tax return, showing thirteen thousand six hundred sixteen dollars. How long was it you stayed with the Peerless company?

A. I stayed with them until the spring of 1942. Actually up to the last of 1942 after I had consummated this deal with Mission Bell. I merely had the job of training somebody to take over my work, and I had those orders on hand from which I received a commission, then I resigned from my

(Testimony of H. Leslie Hoffman.)

position there and devoted all my time to Mission Bell.

Q. Where was the Peerless Production headquarters located?

A. On McKinley Avenue. As I recall it was in the 6,000 block on McKinley Avenue.

Q. In Los Angeles?

A. In Los Angeles. [91]

Q. Was the thirteen thousand the highest you received from the Peerless company?

A. Yes, sir.

Q. What did you actually do there with respect to your duties of supervision and so forth? What were all the titles and positions you held with the Peerless Production Company?

A. Well, titles and what I did were two different things.

Q. Well, tell us exactly what you did.

A. The title I had was sales manager. What I did was to go to the established radio—in the first place, Peerless had never sold anyone except radio jobbers and radio manufacturers, so they had no contact with the electrical trade at all. I went out and showed the electrical jobbers, the fluorescent manufacturers and established a business on this fluorescent ballast or transformer, then in addition to that, due to the pressure of the increased business, they had internal problems and they had a lady running the business and she was having trouble with personnel methods and so forth, and I stayed inside and contributed as much as I could

(Testimony of H. Leslie Hoffman.)

to help out on that phase of it, and during one period I took over the route sales as well and the route agents that they had on sales commissions were answerable to me, although I didn't get anything out of it. [92]

Q. And you did a good deal of traveling in that time, too, didn't you?

A. Yes, sir, and I paid my own expenses.

Q. Then, in 1942 did you cease all your connection with the Peerless? A. Yes, sir.

Q. That was the Peerless Electrical Products Company. That was after you got into the Mission Bell company and this Hoffman Radio Manufacturing Company? A. Yes, sir.

The Court: Now, will you indicate to me, Mr. Crouter, when you have finished that particular line. It is about time to adjourn, but we will finish that particular line.

Mr. Crouter: This would be convenient, because I was just going into the Mission Bell and Hoffman right now.

The Court: We will be recessed at this time until two o'clock.

(Whereupon, a recess was taken until 2:00 p.m. of the same day.) [93]

Afternoon Session—2:00 p.m.

The Court: Proceed.

Whereupon,

H. LESLIE HOFFMAN,

called as a witness for and on behalf of the Petitioner, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Crouter:

Q. Mr. Hoffman, I would just like to have you identify the 1941 return, if the Court please, I believe I will offer it later. That is the original of your 1941 federal income tax return, isn't it?

A. Yes, sir.

Q. Now, referring to the time when you became interested in the Mission Bell Radio Manufacturing Company, the name of which was later changed to the Hoffman Radio Corporation, Mr. Hoffman, please tell the Court in a general way just what the plant and property and tangible assets of that corporation consisted of at the time when you became interested in it in a definite way we will say about December 4, 1941.

A. Well, covering item by item, personnel: we had three employees, which consisted of the president of the company, the shipping clerk and the stenographer. The plant itself was approximately 7500 square feet, which was a converted [94] garage.

Q. What was the location?

(Testimony of H. Leslie Hoffman.)

A. 833 Venice Boulevard, Los Angeles.

Q. I see. All right, go ahead and tell us a little more about what the property consisted of.

A. The property consisted of a converted garage and of course a small office and display space, a stock of materials which contained as I previously testified, one hundred chassis that were completed and twenty or so complete units.

Q. Radio units?

A. Yes, complete radio sets.

Q. Was that the portable table type?

A. No, some of them were—there were about ten combinations and about ten table model types.

Q. I see.

A. And the balance of the stock was a miscellaneous assortment of components that had been accumulated over quite a period of time, and this miscellaneous assortment of components was put on sale, as I previously testified, and sold for a very small amount of money. Their assets were actually much less than their liabilities. They owed quite a considerable sum of money for the company, as I recall it was in excess of ten thousand dollars, and the other thing that they had, which of course was nothing that was an asset unless it was turned into an asset, that was a license from the Radio [95] Corporation of America to manufacture radios.

Q. Do you know how long the corporation had held that license with the R.C.A., as it is referred to?

A. As I recall, they secured that license in 1936.

Q. Referring to the statement about 7500 square

(Testimony of H. Leslie Hoffman.)

feet, did you refer to the land total, or is that the building area?

A. That is the building area.

Q. Did they own their building?

A. No, they rented it.

Q. They rented it? A. Yes, sir.

Q. They didn't own any real property then?

A. No, sir.

Q. That is correct? A. Yes, sir.

Mr. Crouter: If your Honor please, to keep our exhibits in order here, I would like to offer at this time a few of those documents that were included in the stipulation.

Referring to the tax returns involved. There is one paragraph of the stipulation that refers to the 1943 returns of the Petitioner as Exhibits A and B, A being the Form 1120 income and declared value excess profits return, and B being the excess profits tax return for 1943. I would offer those at this time as part of the stipulation.

The Court: Respondent's Exhibits A and B are [96] admitted in evidence.

(The documents above-referred to were received in evidence and marked Respondent's Exhibits A and B.)

[Printer's Note]: Respondent's Exhibits A and B are set out in full at pages 414 to 450 of this printed Record.

By Mr. Crouter:

Q. I show you the 1941 return of the Mission Bell Corporation. Please examine that and state

(Testimony of H. Leslie Hoffman.)

whether that is your signature as president and that is the original return?

A. Yes, sir, it is.

Mr. Crouter: I offer this as Respondent's exhibit next in order.

The Court: Admitted in evidence as Respondent's Exhibit C, by this you mean the 1941 return just identified.

(The document above-referred to was received in evidence and marked Respondent's Exhibit C.)

[Printer's Note]: Respondent's Exhibit C is set out in full at pages 451 to 465 of this printed Record.

Mr. Crouter: Yes, that is the 1941 income and declared value excess profits tax return of the Mission Bell Radio Manufacturing Company. To keep the record clear, I now offer the 1941 original return of Herman Leslie Hoffman, Form 1040, which is the one we previously identified.

The Witness: Yes.

Mr. Crouter: As Exhibit D.

The Court: Admitted in evidence as Respondent's Exhibit D.

(The document above-referred to was received in evidence and marked Respondent's Exhibit D.)

[Printer's Note]: Respondent's Exhibit D is set out in full at pages 466 to 472 of this printed Record.

(Testimony of H. Leslie Hoffman.)

The Witness: That did not include my wife's income, being community property tax.

By Mr. Crouter:

Q. Yes, I appreciate that, and it so shows on the schedules? A. Yes.

Q. Mr. Hoffman, I show you Exhibit C in evidence, this being the 1941 return of the old corporation, if I may refer to it as such, and I call your attention to the items under assets, one item being R.C.A. license contract, carried by the company as an asset with the value of \$17,500.00?

A. Yes.

Q. Have you anything else that you can tell the Court about the value of that and how it was regarded as a part of the valuable property of the corporation, if it was?

A. Yes, I think I might add something to it. In the first place, going back historically in the radio business, at one time or one era of the radio manufacturing business there were a good many different patents, and after the First World War those patents were pooled under the Radio Corporation of America so there would be less confusion in the manufacturing of these units. That didn't actually work out, but here on the coast in the early part of 1930 up until approximately 1941 there were only three licensees, main licensees on the coast. That was Gilfillan, Remmler, and [98] Mission Bell. Gilfillan had the most valuable license, in that he could license other manufacturers to build radios and collect the license from those manufacturers.

(Testimony of H. Leslie Hoffman.)

Q. Is that Gilfillan Brothers you are referring to? A. Yes, sir.

Q. Then did Gilfillan manufacture under such license about the same time that Mission Bell did, we will take the period of the end of 1941?

A. Well, of course they did up until 1940, but as I recall that, Gilfillan had a fire in 1940 and they were out of business for a period of time until they rebuilt their plant, which was, I believe, the latter part of 1940. However, as far as the R.C.A. license is concerned, at the time we took over Mission Bell R.C.A. had loosened up considerably concerning licenses, and as an example Mitchell Hughes had a limited license to build a radio-phonograph combination, and the license that Mission Bell had called for a minimum payment of \$2500.00. That was subsequently waived, but at the time we took over we didn't know whether it would be waived or not. Mitchell Hughes, however, had only a minimum amount to pay, and there were three or four other manufacturers in town who had limited licenses, Packard Bell being one of the major manufacturers I believe got a license about that same time for nothing, so it was hard to estimate at just what the value of the license was, but it had no transferrable value. [99]

Q. That was one of the real factors that influenced you and Messrs. Davidge and Douglas in taking over Mission Bell even with some liabilities, wasn't it?

A. I would answer that question this way, that the reason we rehabilitated Mission Bell instead

(Testimony of H. Leslie Hoffman.)

of letting it go bankrupt was if we had let it go bankrupt it would have automatically lost their license.

Q. Well, isn't the answer to my former question that it was one of the real factors, because at that time you had anticipated going ahead with radio manufacture for some time?

A. That was one of the assets that we saw in the company.

Q. And the Mitchell Hughes matter you referred to came along a little bit after December 4, 1941, did it not? A. Yes, sir, it did.

Q. That came along—will you tell the Court a little more about the acquisition of the business of Mission Hughes along with Mr. Harmon's position there. You took over some of his plant as I understand your testimony and the manufacturing he had previously done, into your organization, tell about when that happened and so forth.

A. Well, that happened in February.

Mr. Milliken: May I suggest that you get the name right, Mr. Hoffman. I believe Mr. Crouter misunderstood the name. Mitchell.

The Witness: Yes, that company Mitchell Hughes was [100] a manufacturer that had been manufacturing high cost or high priced radio-phonograph combinations, that had been started by a gentleman by the name of Alex Hirsch who had financed it, and Mr. Hirsch had started it, and Mr. Harmon was operating it until he had left, and Mr. Hirsch passes away and his son didn't want to operate the business, and through Mr. Har-

(Testimony of H. Leslie Hoffman.)

mon I became interested in it and we bought the Mitchell Hughes inventory, its name, and took over the lease they had on their building, and we subsequently closed up the quarters of the Mission Bell, very shortly thereafter, and consolidated the operation there at Mitchell Hughes.

By Mr. Crouter:

Q. Can you give us a little more definite date as to when you bought Mitchell Hughes?

A. I would prefer to look at the records and give you that date.

Mr. Milliken: May I ask which more definite date do you refer to as what you want, Mr. Crouter?

Mr. Crouter: I mean when the Petitioner corporation bought the Mitchell Hughes assets and so forth.

By Mr. Crouter:

Q. It was some months after December, 1941, is that right?

A. As I recall it was in February, but as I say I can check the date and find out for you. [101]

Mr. Milliken: February of what year?

The Witness: February, 1942.

By Mr. Crouter:

Q. Do you still have that stipulation before you? Well, I can show you mine here. Will you kindly turn to the stipulation exhibits, there, Mr. Hoffman, and particularly to Exhibit 4, that is the first photostat in there, Exhibit 4, if the Court please is the agreement between Mr. Hoffman and Mr. Schmieter regarding the acquisition of cer-

(Testimony of H. Leslie Hoffman.)

tain stock, being 110 shares by Mr. Hoffman. Now, I notice the reference in there on page 4, Mr. Hoffman, the first full paragraph of that exhibit which I will read to you. You will notice, Mr. Hoffman, a reference to dividends. The language I wish to ask you about is, "Hoffman shall in any event at all times when he is not in default under the terms and conditions of this agreement be entitled to receive, have and take all dividends which may be properly declared upon such stock; provided that in the event of default" and so forth. And now at that time, you see that agreement is dated December 1, 1941, how far had you contemplated going in acquiring all of the stock of the old stockholders, you or any one else with you?

A. Our plan at all times was to acquire all of the stock.

Q. Wait, let me ask the same thing in a different way: [102] When did you and Mr. Davidge and Mrs. Douglas first have any written agreement regarding this matter? Is that one in evidence the only one?

A. You refer to the written agreement dated—

Q. Exhibit 7, that is the one dated December 9, 1941. You may wish to examine it. Is that the only agreement in December between you and Mr. Davidge and Mr. Douglas?

A. These agreements, all of these agreements, were written up at the same time and—

Q. By "these" you mean that between you and the old stockholders and you and Mr. Douglas and Mr. Davidge?

(Testimony of H. Leslie Hoffman.)

A. Well, if I may refer to them as exhibit numbers, our Exhibits 4, 5, 6 and 7 were all written up by Mr. Davidge's attorney at the same time. You will see that they are all tied back into the same contracts, in other words Exhibit 4 here recites what is in Exhibit 7 in part.

Q. Well, then, at that point had Mr. Davidge and Mr. Douglas agreed with you in so far as Exhibit 4 is concerned that you were entitled to all the dividends on the stock?

A. At the time that that was agreed to naturally accrue the same rights as I had under my contracts at 25-25 and 50 basis.

Q. Very well. Now, it is correct, is it not, that in the early part of December and before Pearl Harbor you and Mr. Davidge and Mr. Douglas really contemplated just going [103] ahead with the radio manufacturing and assembling business similar to that which Mission Bell had done in the past, is that right?

A. No, it is not entirely right.

Q. What did you contemplate before December 7, 1941?

A. Well, there was another thing I contemplated at that particular time, due to my previous experience in the transformer business and due to the fact that at that particular time there was a company by the name of Phelps Dodge which was selling out their fluorescent and neon transformer business. I remember taking a look at that particular business with the hope that Mission Bell—as a unit we could use to manufacture, represents

(Testimony of H. Leslie Hoffman.)

a possibility of going into other things besides the radio business.

Q. But all along the radio line and commercial and regular domestic manufacture—

A. Flourescent ballasts have nothing to do with radio.

Q. You refer to new lighting equipment and so forth? A. That is right.

Q. Did you ever actually do that? A. No.

Q. Did you ever take any steps to do it?

A. We took the steps of looking over the inventory and the price and a few things like that.

Q. What inventory?

A. The inventory of the Phelps Dodge Company. [104]

Q. Let's refer to Exhibit 5, which is your next exhibit. I see on page 5—and now you will notice this is an agreement of December 4th between you and the two Warners? A. Yes.

Q. On page 5 I wish to ask you about the reference in paragraph 6, refers to sales of merchandise shall be continued, sales of merchandise made by the company, and discounted bills and so forth. That would mean this contemplated the lines of manufacture which you have testified about, didn't it?

A. That was all we could contemplate at that time.

Q. Now referring to next Exhibit No. 6, this is the agreement of December 4, 1941 between you and Mr. P. L. Fleming. Mr. Fleming had been

(Testimony of H. Leslie Hoffman.)

a stockholder in the old company and owned 110 shares, did he not? A. Yes, sir.

Q. And I believe that this agreement says that you were to acquire that for \$2,750.00, which I suppose you did. A. Yes, sir.

Q. By the way, when, if there was any definite date, had all of these amounts which are provided for in the contracts with the old stockholders been fully paid off?

A. They were paid off at different times.

Q. When were they all paid off, do you recall the date that that happened?

A. Oh, yes. They were paid off, as I recall it, [105] completely paid by March, 1943.

Q. By March of 1943. That was \$2,750.00 Mr. Fleming was to be paid, was it?

A. As I recall, they were paid each \$4,825.00 for their stock.

Q. Was that all on or before March, 1943?

A. It was.

Q. Were they paid by installments or all at one time?

A. They were paid by installments. That is provided by the contract.

Q. It was paid out of the profits of the business?

A. Out of the profits, that is right.

Q. Then the stock of all the old stockholders of the company was acquired for the total sum of \$11,755.00, is that correct?

A. That sounds about the right amount.

Q. In accordance with the agreement, those are the figures there? A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. Going over to this next exhibit, that being the one I referred to, the one with Mr. Fleming, please examine page 2 there and particularly with respect to the \$1,500.00 payable to Mr. Fleming. Did he continue as an officer of the old corporation for a while, or what does that refer to, about the middle of the page, where it says it is understood that the [106] company is indebted to Mr. Fleming for the sum of \$1,000.00 and \$2,500.00 salary.

I judge that the latter figure is what was owing him for salary on account of services rendered, and I will ask you if that is a fact.

A. That referred to services which he had performed for Mission Bell Company as president of the corporation.

Q. Did he continue on at all with the new corporation?

A. Yes, sir, he did. In fact he is still with the company.

Q. He is? A. Yes, sir.

Q. What were his duties there?

A. Well, his duties after we took over was to handle the purchases.

Q. Now, up to the time that you had really become interested in acquiring along with others this Mission Bell Manufacturing Company had never had any great experience in the radio manufacture or assembly field, had you?

A. Well, that is according to what you would define as the word "great". I had experience at manufacturing because I started in when I was

(Testimony of H. Leslie Hoffman.)

13 years of age as a kid in the factory on the punch press, and I knew something about tools and dies, and each summer during vacations from school I had some such job, and I did know something about building [107] things, whether it was radios or whether it was machine products. I also had considerable experience in a position where I had to do with the sale of things and setting them up for distribution.

Q. But you had very little practical knowledge in your past with respect to the radio manufacturing business, is that right?

A. My experience predated my association with Mission Bell. My experience in the radio manufacturing business went back to 1928 or 1929.

Q. Is it true that a great deal of what you learn about and personally used in the operation of the Petitioner corporation here, was learned in the first instance from Mr. Fleming?

A. No, sir.

Q. You would say that is not true at all?

A. Absolutely not.

Q. Did he teach you anything about the subject?

A. He taught me some bad habits.

Q. Didn't he teach you any good ones at all?

A. Absolutely not.

Q. You paid him some money for what he told you about the business?

A. We paid him some money for some of the contacts that he had in so far as acquiring materials, his connections.

(Testimony of H. Leslie Hoffman.)

Q. Would you say that is absolutely all? [108]

A. Yes, sir, I would say so definitely, and positively.

Q. You feel quite strongly on that, do you?

A. I do.

Q. I am not proposing to ask how you became convinced of that. I just want to see what the facts are here.

I hand you a document which purports to be a statement apparently in connection with this income tax matter. Please examine that and state whether or not that is your signature.

A. That is my signature.

Q. That is your signature? A. Yes, sir.

Q. And that is the signature of your wife, is that so? A. That is right.

Q. This was sworn to before a notary public as indicated at the bottom? A. Yes, sir.

Mr. Crouter: I will hand you a copy of this letter and ask you to look at the last paragraph of page 2 and the statement therein contained. Then I want to ask you one more question about it. I will offer this document in evidence.

The Witness: Wait just a minute. If I may I want to read it. That is substantially correct.

Mr. Crouter: I offer this as Respondent's exhibit [109] next in order, just for the record, this being a statement by H. Leslie Hoffman and Elaine Hoffman regarding calendar year 1943, being dated December 18, 1945.

The Court: Being the statement just identified by the witness?

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: That is correct.

Mr. Milliken: I would like to ask to see it before it is introduced.

Mr. Crouter: Yes, excuse me, I haven't shown that to counsel. I assumed you had seen that. I am offering that particularly for impeachment purposes and also to show—

Mr. Milliken: Impeachment, that is as far as you need to go, if it is for impeachment.

The Court: Admitted in evidence as Respondent's Exhibit E.

(The document above-referred to was received in evidence and marked Respondent's Exhibit E.)

[Printer's Note]: Respondent's Exhibit E is set out in full at page 473 of this printed Record.

By Mr. Crouter:

Q. Did I understand you to say, Mr. Hoffman, that the statements in Exhibit E are substantially correct? A. That is right.

Q. Referring to the statement in the last paragraph on page 2, "Mr. P. L. Fleming was connected with the corporation at the time Mr. Hoffman became interested in its possibilities, and Mr. Hoffman agreed with Mr. Fleming that if he would [110] acquaint him with the radio manufacturing business and lend him aid and assistance in the organization of the company, he would pay to Mr. Fleming the sum of \$1,500.00." That refers to Mr. Fleming acquainting you with the radio business, doesn't it? A. That is right.

(Testimony of H. Leslie Hoffman.)

Q. And he was to lend you any aid and assistance in reorganizing the company?

A. Yes, that was the theory of it. You asked me the direct question as to actually what happened.

Q. Well, I wanted to know whether it is not a fact or what made you say this, that Mr. Fleming had acquainted you with the radio manufacturing business.

Mr. Milliken: I object to that, your Honor. He has covered that in his first direct examination. He was asked if he knew Fleming at that time and he said no. This is no impeachment of his testimony. He certainly knew Fleming following that and paid him that \$1,500.00.

Mr. Crouter: I will withdraw the question. I think the record is clear as to what the question was.

Mr. Milliken: I think it is very clear.

By Mr. Crouter:

Q. Let's take one other little matter shown in Exhibit 6, which I believe is still before you. Please turn to page 2 of that exhibit, page 2-A, which is the third page of the [111] exhibit itself, and near the end of that paragraph, Mr. Hoffman, regarding the \$12,000.00, you may wish to examine the first part of that, which is paragraph 2 of the agreement, "It is understood that said company is indebted to Fleming" and so forth.

Mr. Milliken: Pardon me, Mr. Crouter. May I get your reference to that again?

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: It is page 2-A of Exhibit 6.

The Court: What part of the page?

Mr. Crouter: The last sentence in that paragraph, and it is the first half of page 2-A.

By Mr. Crouter:

Q. Please examine that, Mr. Hoffman, where it says, "Fleming further agrees for the benefit of the company" and so forth, and then the latter part, "It being expressly agreed that for the purpose of determining whether or not said company is in a position to pay such dividends the compensation which will be paid to officers and/or employees of said company prior to the payment of dividends to stockholders of said company shall be payment to aggregate not more than \$12,000.00" Is that the way in which that \$12,000.00 arose? Was it either past salaries or future salaries, as you understand it?

A. I think that the previous sentence gives you the answer. It says Fleming further agrees especially for the [112] benefit of such company as well as for the benefit of Hoffman that he will not take action to enforce his claim against said company for salary earned and unpaid prior to January 15, 1943, and that on January 15, 1943 he will consent to further extension of the time of payment of such claim unless at or prior to January 15, 1943 said company is in a position to pay dividends on its stock aggregating the sum of \$1,500.00.

Q. Did you understand that to refer to Mr. Fleming's salary or to some one else's?

(Testimony of H. Leslie Hoffman.)

A. You refer to the \$12,000.00 mentioned in the paragraph?

Q. Did he mention it in the paragraph?

A. No, it sets it out clearly, I would think. It referred to dividends.

Q. It says salary not to aggregate more than \$12,000.00 will be paid to the officers and stockholders of such company, so that would include you, would it not?

A. Yes, sir, it would.

Q. Do I understand Mr. Davidge and Mr. Douglas were also agreeable to that provision?

A. Yes, sir.

Q. Then it is true that there was another agreement here, and you have the minutes of December 4, 1941, that being Exhibit 12, and I wish you would turn to that if you will, please. These are the minutes of December 4, 1941, referring to the three percent of all gross? [113]

A. That is right.

Q. Those are the payments to be paid over and above your regular salaries?

A. Yes.

Q. That extended for a period of thirty-six months?

A. Yes, to the best of my recollection.

Q. You had a definite agreement of that character with the old stockholders before Mr. Davidge and Mr. Douglas signed any agreement with you as to the three percent provision, is that right?

A. That is not correct.

Q. You did have the agreement with Mr. Fleming to that effect when you were negotiating with him, did you not?

(Testimony of H. Leslie Hoffman.)

A. The actual facts of this matter are these: that as I previously testified this salary arrangement and all these other contracts were drawn up by Davidge's attorney, Mr. Walker. Davidge's attorney advised that it would be best for the outgoing board of directors to approve this salary arrangement, and Davidge and Douglas were thoroughly familiar with that arrangement, inasmuch as it was their attorney that advised it.

Q. Did they raise any question about such three percent payments going to you being excessive?

A. Who do you refer to as "they"?

Q. Davidge and Douglas. [114]

A. No, sir, that was in our arrangement.

Q. Did they ever raise any question about that?

A. No, sir.

Q. They did at the expiration of the three-year period, did they not? A. No, sir.

Q. Did anyone? A. Beg pardon?

Q. Did anyone? A. Who do you refer to?

Q. Did anyone object to the three percent as being excessive at the end of the period?

A. Well, "anyone" is a very ambiguous word.

Q. Anyone having any contractual rights there?

A. Well, now, just what period do you refer to?

Q. Soon after the end of the three-year period, Mr. Hoffman. Well, the following three-year period commencing with January 15, 1943, it was changed and reduced a great deal, isn't that a fact?

A. No, sir. Again you are talking in very ambiguous terms.

(Testimony of H. Leslie Hoffman.)

Mr. Milliken: I object to counsel—

Mr. Crouter: I will be a little more specific.

The Witness: If you would ask me specific questions—

Mr. Milliken: Just a moment please. [115]

The Witness: Certainly.

Mr. Milliken: I object to counsel going beyond the year 1943 on any one of these matters.

Mr. Crouter: If your Honor, please, I submit that I am entitled to test the accuracy and reliability and credibility of this witness to some extent, and he makes some very emphatic statements that something never happened. I believe I am entitled to follow that up, since it bears right on the question of salary, and see whether his answer is correct or not.

The Court: We will settle that right now. We will go beyond 1943 then. That is the reason I withheld my ruling on that matter earlier. I think at this time it is apparent that to get a complete picture it probably will be necessary to come somewhat down beyond 1943. You will be permitted to ask questions, and later I will admit the instrument that was offered that covered 1944, I believe. I don't say at this time that we will come any further down than 1944. There has to be somewhere a reasonable line of demarcation in these matters. Proceed.

By Mr. Crouter:

Q. Mr. Hoffman, I show to you a document here which is labeled "Prospectus of Hoffman Radio

(Testimony of H. Leslie Hoffman.)

Corporation." I believe you are familiar with it, are you not? A. That is right. [116]

Q. You signed the original of it, did you not?

A. That is right.

Q. And at page 35 of this prospectus I call your attention to the paragraph, about the middle of that page, referring to— A. My income?

Q. Certain income, salaries, and so forth, and a change made for the period from May 1, 1946 to April 30, 1949? A. That is right.

Q. That change was made, was it not?

A. That is right.

Q. Just exactly as stated in the paragraph?

A. That is right.

Mr. Crouter: I offer this document, if the Court please, this being the prospectus of the Hoffman Radio Corporation relative to issuance of shares of common stock.

Mr. Milliken: No objection.

The Court: Now just a moment. You say that covers 1946 to 1949?

Mr. Milliken: Yes, your Honor. That is why that I think it becomes immaterial. It will be necessary for me now, if that document is under the limitation, we will show there was a public offering of this stock in 1946. I am going to show that Mr. Hoffman's salary in connection with that was [117] \$35,000.00 a year, that he agreed to reduce it to \$35,000.00. He was given a bonus arrangement of 12 percent on all the profits over \$100,000.00. He was likewise given a number of other executive

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(Testimony of H. Leslie Hoffman.)

offices that came into this corporation and that took on functions that Mr. Hoffman had been performing in the year 1943, with which we are concerned. Mr. Hoffman had duties after duties removed from his responsibility. That is no criterion as to what his compensation should be for the year 1943.

The Court: Well, as I said a few moments ago, somewhere there has to be a line of demarcation that dictates what is helpful to me, and that is the question here in the long run, what is helpful to the Court in deciding what the situation was in 1943. It seems to me that although you made this offer and Petitioner has not objected because apparently he would rather like to go into the matter too, just from my standpoint it seems to me that you are getting on very thin ice, to use that expression, so far as offering anything actually helpful in 1943. Why is this going to help me on 1943, if you have any theory on that? This is three years after that date.

Mr. Crouter: Well, I don't know. I hope counsel remembers that the facts now in evidence, as shown by paragraph 18, show that the employees increased, 1944 there being 351 as against 297, in 1945, 462 and 1946, 765. I don't want [118] to go too far afield in the other year, if the Court please, but I believe that they have a bearing directly on the answers given by the witness here, and I believe his testimony prior to that matter would infer that there had never been any change from the three percent of the gross arrangement. I believe

(Testimony of H. Leslie Hoffman.)

I am entitled to go into that, and I do not propose to go far afield on these later years.

Mr. Milliken: Well, the answer, it would seem to me, your Honor, if you will bear with me, is that counsel is obviously endeavoring to show that this three percent was too high in 1943 by showing that in 1946 they changed to some other basis lower than that. Then we have to show why that is so, and we have got abundant evidence to support that, but it just takes a great deal of time.

The Court: For the present time at least I am not going to admit this instrument. It is too far afield. No objection was made—

Mr. Crouter: I will withdraw the exhibit.

The Court: Petitioner's salary 1946 to 1949; we will be here forever trying this case if this keeps on. I want you to try your case properly, but there is no reason as far as I can see to expect that the years 1946 to 1949 even establish what the reasonable value in 1943 is.

By Mr. Crouter:

Q. Mr. Hoffman, at the time that you and Mr. Davidge [119] and Mr. Douglas went into Mission Bell and acquired your interests in the corporation, it really was not established as a radio manufacturing company, was it? A. No, it wasn't.

Q. Isn't that true at the time you negotiated with people having war contracts, other corporations having war contracts, so that your corporation was more or less compelled to just come in as a subcontractor?

(Testimony of H. Leslie Hoffman.)

A. Our corporation was forced to get business where they could get it.

Q. You had no prime contracts at all for the federal government in 1942, did you?

A. Yes, sir.

Q. Oh, yes, I see one stipulated, \$178.

A. That is that contract I referred to previously. It was actually \$1400.

Q. And one other on which you apparently received \$336.28.

A. I believe we have a stipulation listing the contracts and their dates, do we not?

Q. I don't know if that is included here in the stipulation, because most of your work was really subcontracting all through your 1942 orders, isn't that right? I mean as far as government is concerned. Inspecting your Exhibit 2, I find you had subcontracts chiefly which you got from the prime contractors, Bendix Aviation and Kingston Products?

A. Those are the actual sales, yes, sir.

Q. And that was really due to the fact that the government at that time required the manufacture and production [121] of a great many things which are absolutely new not only to your corporation but also other corporations, isn't that right?

A. Yes, sir.

Q. Referring to the renegotiation reports for 1942 and 1943, I suppose that the Bendix Aviation and Kingston Products already had their orders that they were filling for the government and you in a sense just helped to fill those orders under subcontract, isn't that the size of it?

(Testimony of H. Leslie Hoffman.)

A. Bendix Aviation and Kingston Products were prime contractors and they were to subcontract certain components and certain assemblies, and we handled their requirements of the two particular things.

Q. You refer to the variable condenser?

A. Yes, sir.

Q. And the antenna kite that you testified to?

A. Yes, sir.

Q. Do I understand you to say that you, I mean you and your company and anyone employed by it, manufactured something that was new in design and model and so forth, or was it just from plans that were furnished?

A. It was a combination of both. They had a function that they wanted to perform with the variable and with the kite, and they gave us some rough drawings on it. We started in with the rough drawings and redesigned it, both for their [122] performance and for their manufacture, and so it was really a combination of both. They had prints covering the various things, but we contributed a great many different changes at subsequent times.

Q. Most of them were really laid out by the plans and specifications of the military branches concerned?

A. No, sir, they were not.

Q. Isn't that right?

A. No, sir, that is not right.

Q. Well, let's get on to Exhibit 4 here in evidence. As I understand it the number on the jobs shown on this are the numbers of the various other companies?

A. That is right.

(Testimony of H. Leslie Hoffman.)

Q. And in that column it shows for the Bendix Aviation one here for the variable condensers?

A. That is right.

Q. That is 4LCD5220W, it being dated February 12, 1943. Now, Bendix and the government had already arrived at very definite standards and specifications as to what they wanted, had they not?

A. There is a difference there which is a technicality. They had arrived at the performance specifications of what they wanted it to do.

Q. But in this case Bendix or other corporations already produced certain things along that line of the contracts for [123] the military departments, and were furnishing those?

A. Well, actually the whole unit was an English design, and then we took it and modified it.

Q. Did anyone in your corporation get any patents on any of those things you manufactured on government prime contracts or subcontracts?

A. Patents were not applied for, generally speaking, during the war, because the patents were waived anyway.

Q. A sort of a pool of patents?

A. Yes, sir.

Q. I mean for war production.

A. All patents and all licenses were waived.

Q. How many different things would you say the Hoffman Radio Manufacturing Company turned out separate and apart from any design that was previously furnished, during 1942 and 1943?

(Testimony of H. Leslie Hoffman.)

A. Would you rephrase your question, please?

Q. I mean different new designs or models or condensers or kites or anything else along that line.

A. 1942 and 1943?

Q. That is right.

Mr. Milliken: If I may interrupt you, evidence that we will put on will show all the things that they redesigned in the years 1942 and 1943, and I think the witness will take them up and more specifically answer the question. [124] They were all things made in 1942, 1943 and 1944.

Mr. Crouter: Counsel is not testifying, and I haven't had a chance to look at this.

Mr. Milliken: Well, I just thought I would facilitate your examination.

Mr. Crouter: Will this be covered by other witnesses?

Mr. Milliken: Yes.

By Mr. Crouter:

Q. Can you answer the question, Mr. Hoffman? Do you know?

A. The period with 1942 and 1943?

Q. That is right.

A. Well now, let's see. I would say roughly seven different types of units.

Q. And you had nothing to do with the real invention or designing of any of those, did you, you personally?

A. Yes, I think I can claim certainly some contribution there.

Q. How many of the seven did you personally do any substantial portion of the work going into

(Testimony of H. Leslie Hoffman.)

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A. Yes, I think I can claim certainly some contribution there.

Q. How many of the seven did you personally do any substantial portion of the work going into

(Testimony of H. Leslie Hoffman.)

the development and perfection of the device?

A. Well, I personally didn't do any that I considered was designing of it. However, of the seven, four of them were conceived in a laboratory that I was instrumental in setting [125] up, and had it not been for that particular laboratory and my initiative in setting it up, the government would have been without some rather important circuits that were developed in that laboratory.

Q. Was that the extent of your participation on such matters? A. No, it was not.

Q. Just setting up the over-all supervision and the mechanics in the plant where it could be done?

A. I contributed some things on the mechanical design of it, but generally speaking Mr. Harmon was the head of that.

Q. He was your head engineer, was he?

A. Yes, sir.

Q. And you had subordinate engineers who chiefly worked on those matters, isn't that right?

A. We had one or two at that time, yes. That was in 1942.

Q. In connection with the plant that you had, where was the plant located and the office and so forth in 1943?

A. 1943 it was at 3430 South Hill.

Q. When was it moved to the location about 3751 South Hill? Is that the correct address?

A. 3761.

Q. Yes. A. That was March, 1946. [126]

Q. Did the company acquire or own any real property? A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. Of its own during 1943? A. Yes, sir.

Q. About what was the over-all considering in acquiring the Mitchell-Hughes plants, its assets?

A. As I recall it, there was approximately sixteen or seventeen thousand dollars. Ten thousand of which we paid immediately.

Q. And that included everything you testified to that came over except personnel?

A. Pardon me?

Q. That included all the property except your personnel arrangements, your contracts with personnel, isn't that right?

A. I am sorry. I don't understand your question.

Q. Was sixteen thousand dollars the over-all consideration for everything you acquired in the Mitchell-Hughes Company? A. Yes, sir.

Q. Mr. Harmon really brought over through or he was instrumental in having a good many of the former employees of Mitchell-Hughes come over and go with your corporation, is that right?

A. No, you have it a little bit wrong. We didn't remove Mitchell-Hughes employees to Mission Bell. Mitchell- [127] Hughes had the employees and we moved Mission Bell into Mitchell-Hughes.

Q. They came with your company is what I mean by that, they worked for your company?

A. Yes, sir, they transferred from Mitchell-Hughes to Mission Bell.

Q. Yes. Did I understand you to say that you and possibly some others worked for a period of four or five days without any sleep?

(Testimony of H. Leslie Hoffman.)

A. That is right.

Q. Do you really mean that, Mr. Hoffman?

A. I mean it very sincerely.

Q. Day and night? A. Day and night.

Q. You lived pretty near your plant, did you not? A. No, I lived in Alhambra.

Q. Who was it that did that job and worked that way?

A. Well, actually there was Harmon, a chap by the name of Cliff Larken, a chap by the name of Dillen, Fleming, Mr. Douglas came down and worked and I stayed there and some of the boys went home and caught some sleep. I went back and laid down for a little while. Hell, that was the only way we ever got the job done.

The Court: Now just a moment. We don't need profanity in this Court. [128]

The Witness: I apologize, your Honor.

The Court: If you are quoting someone else, of course that is a different proposition, but it is not necessary. I am no stickler on that, but the Court doesn't appreciate it.

By Mr. Crouter:

Q. You didn't keep going from Monday morning to the following Sunday night without any sleep, did you?

A. It was not Monday morning. It was Wednesday morning.

Q. It was from Wednesday morning until the following Sunday night?

A. Until the following Sunday night.

Q. Straight through without sleep at all?

(Testimony of H. Leslie Hoffman.)

The Court: I think probably your earlier testimony was mistaken then, because I understood Monday morning.

The Witness: If I said Monday, I misspoke myself. It was Wednesday.

By Mr. Crouter:

Q. Referring to the 1943 tax return, Mr. Hoffman, I want you to examine the list of assets of the company so the Court can tell about what the tangible assets consisted of at the end of the year 1943. Some of those may need some explanation. I am referring now to Exhibits A and B. You see that has the heading of assets, and getting down to the property account, can you tell the Court by reference to those figures, [129] especially those for the end of the year, you have a total here of \$91,214.54, and it doesn't seem to be allocated between land and other property. There is a division of 2,282 and 88,932. What did that chiefly consist of at the end of 1943?

A. The major asset was the plant at 3761 South Hill.

Q. What was the status of that plant as to ownership by the corporation? Had it acquired title to it at that time or was it acquiring it?

A. It was in the process of acquiring it. The cost of the property which included the building of 18,500 feet and land of 37,000 feet was approximately fifty-five thousand dollars, as I recall it.

Q. That occurred during 1943?

A. As I recall, it was June of 1943. You see, we needed additional facilities to handle this navy

(Testimony of H. Leslie Hoffman.)

contract, and at that Mr. Douglas, Mr. Davidge and myself went into it on approximately a three way basis and contributed the money to make up the \$25,000 down payment.

Q. Had that really been secured in large measure from earnings or what yourself had secured out of the corporation as compensation, insofar as your part of it was concerned?

A. Frankly, I don't remember where it had been secured from.

Q. Well, was the entire \$55,000 paid off so you had a [130] clear title at the end of the year?

A. No, it was not paid off by the end of the year. It subsequently paid off, yes, sir, but just when it was completely paid off I don't recall.

Q. That plant was really regarded as a war facility at the time it was originally acquired, was it not?

A. Yes, sir, we secured a certificate of necessity on it.

Q. So that it was subject to amortization under Section 1241 of the Internal Revenue Act?

A. Frankly, I don't know whether that is the section or not, but it was subject to rapid amortization.

Q. So you did have a very substantial plant there by the end of the year, didn't you?

A. Yes, we had a good plant.

Q. About how much was the building space there in 1943? A. 18,500 feet.

Q. Does the plant cover all the block down there now? A. No, sir.

(Testimony of H. Leslie Hoffman.)

Q. Did it at the end of 1943 cover half or two-thirds of that block?

A. No, sir. That is a very big block.

Q. What is the outside measurement of the lot there?

A. I would say we have 200 feet and I would say that the block was all of 2,000 feet long. [131]

Q. Did the plant at that time extend from Hill Street over to Grand Avenue, just the way it is now?

A. Well, the reason I was hesitating was we acquired the lot between Grand Avenue and the building after we acquired the original property.

Q. I see.

A. And I have forgotten just when we acquired that lot.

Q. That was a corner location on Hill Street and 38th Street?

A. No, it is not a corner location.

Q. It wasn't then?

A. No, it is in the middle of the block, or it is off the corner of the block about 200 feet.

Q. As I understand it, no stockholder of any kind received any dividends as such out of the Petitioner corporation for the year 1943, is that correct?

A. That is correct. We couldn't pay a dividend due to our arrangement with the California Bank.

Mr. Crouter: I believe that is all.

(Testimony of H. Leslie Hoffman.)

Redirect Examination

By Mr. Milliken:

Q. Mr. Hoffman, counsel has asked you about the license agreement that the corporation had with the Radio Corporation of America, and I will ask you if this is a copy of the license agreement or the original rather? [132]

A. 1940, it ran until 1946, I think. When it expired can't tell. There have been several of those.

Q. Well, it is signed there by officials of Mission Bell, Fleming—

A. I was trying to find out when this expired. The one that we had expired December 31, 1946. I think that is it, yes.

Q. Was that the agreement that was in force when you acquired—

A. I am quite sure it is. I couldn't find the expiration date, but the one we had expired December 31, 1946.

Q. I will refer you to Section 8 and ask you what money payment it is that is provided in Section 8?

A. The money payment was \$5,000.

Q. If you testified to \$2,500 on cross-examination, were you in error?

A. Yes, I was in error.

Q. So that if Mission Bell had not paid over \$5,000 in 1941 it would have been subject to cancellation, as I understand it?

A. Yes, sir, that is right.

Q. And did they pay the \$5,000 in 1941?

(Testimony of H. Leslie Hoffman.)

A. No, they didn't pay the \$5,000 in 1941, because the R.C.A. gave them a waiver on that particular paragraph. That was received, as I recall it, in March of 1942. [133]

Q. I show you a document and ask you if you can identify it?

A. This is our agreement between the California Bank and ourselves.

Q. Agreement between the California Bank and your corporation? Speak up a little bit. I don't think the Court can hear.

A. This is our agreement on our V loan with the California Bank between Mission Bell Radio Manufacturing Company and California Bank.

Q. I will ask you to read the A on page four and subdivision four.

A. "Without the prior written consent of the bank, the prior written consent of the Federal Reserve Bank of San Francisco as fiscal agent of the United States acting on behalf of the guarantor named in the agreement herein referred to, borrower will not declare or pay any cash dividend upon its capital stock or acquire any of its outstanding stock or otherwise make any change in its capital structure, or merge or consolidate with or into any other corporation, or convey, sell, lease or transfer assets the ownership of which is necessary to continuation of its business."

Q. Is that the basis for your statement to counsel for the Respondent that you were prohibited in the year 1943 from paying cash dividends? [134]

(Testimony of H. Leslie Hoffman.)

A. Yes, sir.

Q. Referring to the same agreement then to paragraph 8, subparagraph 8 of paragraph A on page four, I will ask you to read that as well.

Mr. Crouter: If your Honor please, this has not been offered. I don't know whether counsel proposes to offer it, but I would like to see that document before it is all read in the record.

Mr. Milliken: I am just asking if that is the document that he pursuant to the loan agreement. He says that is the original.

Mr. Crouter: I object to counsel or the witness reading anything and getting the document in the record without having it introduced in the record.

The Court: Ask him what it is, of course, before you have it read. Let's have it in evidence.

Mr. Milliken: I offer the exhibit in its entirety as Petitioner's exhibit next in order.

Mr. Crouter: May I see it?

Mr. Milliken: This consists of, if it please the Court, of two documents.

The Court: Let the two instruments together be admitted in evidence as Petitioner's Exhibit No. 5.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 5.)

[Printer's Note]: Exhibit No. 5 is set out in full at page 394 of this printed Record. [135]

(Testimony of H. Leslie Hoffman.)

Mr. Crouter: There is no objection. I didn't know counsel had offered that.

Mr. Milliken: I ask the privilege of substituting a photostatic copy, since this is the original agreement.

The Court: Permission will be so given.

By Mr. Milliken:

Q. Now, if you will refer to paragraph, subparagraph 8 of paragraph A on page four, read that, please, Mr. Hoffman.

A. "Permit borrowers officers or directors each more than the aggregate sum of \$15,000 cash per calendar month as salaries or make any cash payments to the various officers and directors as fees, bonuses, or otherwise except pursuant to agreements which were all ready in effect on January 1, 1942."

Q. Did you personally handle the negotiations with the California Bank incident to this loan?

A. Yes, sir, I did.

Q. Did the California Bank incident to that loan refer to and recognize your contract with the corporation which has been introduced in evidence and entered into on December 4, 1941?

A. Yes, sir.

Q. Mr. Crouter has asked you with respect to the business done in the year 1942, and I ask you to look at Exhibit 2 of the stipulation, and its title, Commercial Receipts [136] \$122,799.03. Did this represent the sale of radios?

A. Yes, sir.

(Testimony of H. Leslie Hoffman.)

Q. Commercial radios? A. Yes, sir.

Q. Who had manufactured those radios?

A. No one had manufactured them. We had manufactured them ourselves.

Q. Who do you mean by yourselves?

A. Mission Bell.

Q. So that represented the sale of their product during the year?

A. Those that we had manufactured after January.

Q. Manufactured after January 1, 1942?

A. Yes, sir.

Mr. Milliken: I believe that is all.

Recross-Examination

By Mr. Crouter:

Q. Just a few questions, Mr. Hoffman. Referring to Exhibit 5, one of the documents being the agreement between your company and the bank, as I understand it, and your testimony as to the consent of the bank being necessary in order to pay any dividends, please tell the Court whether at any time during 1943 or after that year, but counting the year 1943, your corporation made any application to the California Bank in any manner to secure its consent to pay any dividend. [137]

A. During the year of 1943?

Q. During the year or after the end of the year but relating to 1943 earnings.

A. There was no application made that I know of which referred to 1943.

Q. Your company never proposed it and never took the subject up with the bank, is that right?

(Testimony of H. Leslie Hoffman.)

A. Never for 1943. That is the year we are discussing.

Q. I see. On the salary question, you testified to what you considered was really covered by agreements prior to January 1, 1941 as shown by the record here, isn't that the situation?

A. Yes, sir.

Q. Was there any discussion at any time in which you participated at, in or among the officers or directors of the Petitioner corporation with respect to the question whether a dividend would or would not be declared on outstanding stock for year 1943? A. Yes, sir.

Q. When was that?

A. It was discussed at various times between Mr. Douglas, Mr. Davidge and myself.

Q. Are there any minutes of any meeting covering that subject, referring to dividends in any respect?

A. No, sir. The way we handled our corporation minutes [138] was we never had anything in our minutes that we didn't actually get done, as I recall.

Q. Tell us about the discussion.

A. Well, as I recall it it occurred at various times. You see Mr. Douglas and Mr. Davidge had gone into service, and I would see them periodically and write them monthly as to progress, what was going on, and I would discuss with them whether or not they thought that any dividends should be paid, and their universal attitude was that there should be no dividends paid while the

(Testimony of H. Leslie Hoffman.)

company was in a growth position, and of course we were—our hands were tied, even though we wanted to pay a dividend.

Q. Referring to the growth position, you mean because it was handling a lot of new orders and also acquiring considerable new property?

A. I think growth—I don't think that is a complete definition of growth, but that is part of growth.

Q. Is that mainly what you have in mind there when you use the phrase, or what do you mean?

A. When I use the phrase I mean the growth in the volume of business the company was handling.

Q. That indicated that you expected it to have more earnings then, didn't it?

A. That is the object of any business, sir.

Q. One further question I should have asked before, [139] if the Court please. Referring to the renegotiating matters you testified about this morning and some voluntary turning back of amounts by rearranging of contracts and so forth, was that really when those contracts were being investigated and the question was under consideration with the military offices?

A. There was no investigation, sir.

Q. At no time?

A. We did the work voluntarily, but you see there were several different types of contracts. There was a type of contract that had what we call a redetermination of price in it. After a cer-

(Testimony of H. Leslie Hoffman.)

tain percentage, in some cases it was 50 percent, of the contract had been executed and the contractor had experience, then he would estimate the new price, and of course it was—you could not only go up but you could go down, and part of the \$100,000 was from one of those contracts which had the redetermination clause in it.

Q. Did that happen in 1943 or was that later?

A. There was \$1,000,000 that actually came out of the 1943 operation. I am quite sure there was more later, but that is what was applicable to 1943.

Q. Was that done as an incident to the securing of further contracts with the government?

A. Well, it was done as an incident of equity.

Q. You just did it voluntarily, your corporation, without any communication at all with the government agent or [140] military branch?

A. No, that was not the case. I mean—

Q. Please tell the Court what the facts were then.

A. Well, I tried to tell you that those were different in each individual case, and you are trying to get me to make general statements which are not always applicable to individual cases.

Q. Tell us about that one.

A. In that case that I referred to, that one was a contract that had a redetermination price in it. As an example, the amount was a very substantial one, six figures in one contract that we were dealing with, and we only spent ten percent of what we had allocated to it, and in as much as

(Testimony of H. Leslie Hoffman.)

we had been able to effect that saving we passed it on.

Q. And you undoubtedly agreed among yourselves that there would be a renegotiation or adjustment if you didn't go ahead **and make it first** did you not?

A. We thought it was better to do it voluntarily rather than under pressure.

Q. Yes, and I presume the reason is that you go ahead on future business.

A. Well, we were not trying to exploit the **thing**. We thought we were entitled to a fair profit, and after that we remitted **the rest**.

Q. But even with all that you still felt that you had [141] no money at all to use for dividends, was that the situation?

A. The belief was that we could not pay a dividend under our bank loan.

Q. But this agreement which is shown in evidence as Exhibit 5 refers to after July, 1943, but prior to that time there wasn't any contract restricting any payment of dividends, was there?

A. Frankly, I don't recall.

Q. You don't know of any, do you?

A. I would have to look at the records before I could answer that.

Q. Is there any definite contract between the Hoffman Radio Corporation and any bank which restricted the payment of dividends prior to the contracts shown by Exhibit 5?

A. There was a prior contract when we had a loan of \$200,000 in 1942, but I would have to

(Testimony of H. Leslie Hoffman.)

look the contract up to see whether or not there was a restriction on dividends or not. I am under the impression that there was.

Mr. Crouter: That is all.

Mr. Milliken: That is all, Mr. Hoffman.

The Court: Let me ask the witness a question.

The Witness: Certainly.

Q. (By the Court): A few minutes ago you were asked about the sales in 1942 of commercial radios in the amount of \$122,799.03? [142]

A. Yes, sir.

Q. As shown by Exhibit 2 attached to the stipulation. I understand you to say that that was commercial radios manufactured after January 1, 1942?

A. Yes, sir.

Q. I have been wondering what became of the radios, I am under the impression something like 100 altogether that were on hand when you went into this matter, roughly speaking as of the 4th of December, 1941

A. We sold most of those, your Honor, for the Christmas trade in 1941.

Q. That is what I wanted to know. You didn't have any substantial amount of them left over.

A. No, sir.

Q. In 1942?

A. That is right. The only ones that we had left over with the possible exception of five or six, which wouldn't amount to **more than two or three**

(Testimony of H. Leslie Hoffman.)

hundred dollars, was the units that were partially finished, and we had to buy the component parts to finish the assembly and then sell them.

The Court: That answers my inquiry. Call your next witness.

Mr. Milliken: Mr. Clippinger. [143]

Whereupon,

JOHN H. CLIPPINGER,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Tell us your name, Mr. Witness.

The Witness: John H. Clippinger.

Direct Examination

By Mr. Milliken:

Q. Mr. Clippinger, where do you reside?

A. 600 North Saltair, Los Angeles.

Q. That is a suburb of Los Angeles?

A. No, that is Los Angeles.

Q. How long have you lived here, Mr. Clippinger? A. Three years next month.

Q. Where did you live prior to that time?

A. Chicago, Illinois.

Q. How long had you lived in Chicago prior to that time? A. Approximately ten years.

Q. Were you engaged in business in Chicago?

A. Yes, sir.

Q. What business?

A. Radio manufacturing.

Q. With what company were you identified, if it was a company? [144]

(Testimony of John H. Clippinger.)

A. Continental Radio Corporation, which was succeeded by the Admiral Corporation.

Q. In the year 1943 were you then connected with the Admiral Corporation or its predecessors?

A. Yes, sir.

Q. In what capacity?

A. Vice-president in charge of all sales and general activities of the company.

Q. Do you remember the volume of sales of that company during the year 1943?

A. If I recall, and I believe I do because I checked it before coming down here, it was approximately around seven and one-half million dollars.

Q. Did they engage in the sale of commercial radios? A. Yes, sir.

Q. What was your compensation as vice-president of that company?

A. My total earnings which included dividends of the stock I held, because it was a wholly owned company of about five of us, approximately forty to fifty thousand dollars a year.

Q. What out of that forty or fifty thousand a year would represent dividends?

A. Oh, approximately ten thousand dollars.

Q. So then, you were paid then how much—I am trying—— [145]

A. The salary was \$35,000 a year, if that is——

Q. \$35,000 a year? A. That is right.

Q. And you were the vice-president in charge of sales? A. Yes, sir.

Q. Did the corporation have a president?

(Testimony of John H. Clippinger.)

A. Yes, sir.

Q. What was his salary?

A. His salary was \$50,000.

Q. Did they have any other officers?

A. Yes, sir. There was another vice-president in charge of manufacturing.

Q. What was he paid?

A. He was paid, I think it was \$30,000.

Q. Were there any other officers?

A. The treasurer was paid approximately fifteen or eighteen, I don't recall exactly; the secretary around fifteen, assistant secretary and assistant treasurer were paid \$12,000 a year.

Q. Did that corporation have a Washington representative?

A. We had a Washington representative, yes, sir.

Q. What was his duty?

A. His duty was just doing the leg work for me, errand boy. [146]

Q. Do you know what you paid him?

A. Yes, we paid him \$8600 a year.

Q. Do you have any statement, any profit and loss statement or balance sheet of your corporation as of December 31, 1942?

A. I think it is 1942 or 1943. Yes, 1942.

Q. Is that the balance sheet of your corporation that you received as vice-president of the company? A. Yes, sir.

Q. Is the general administrative expense shown with respect to your company?

A. Yes, sir.

Q. What per cent does that show?

(Testimony of John H. Clippinger.)

A. 7.71 percent.

Q. Of what? A. Of the total business.

The Court: What is that a percentage of, a percentage of what else?

The Witness: Well, there was 7.71 of the seven million some dollars worth of business.

Q. (By Mr. Milliken): In other words, of the gross business shown of seven million odd dollars, the administrative expense was 7.71 per cent.

A. Yes. The net sales, it says on here, that per cent [147] of net sales.

Mr. Crouter: Is counsel offering that document?

Mr. Milliken: No, I am not. I am introducing this witness as an expert on——

Mr. Crouter: I see. The one back of this is another exhibit.

Mr. Milliken: That is a different exhibit.

Mr. Crouter: Very well.

Q. (By Mr. Milliken): How long before the year 1943 had you been engaged in the radio business?

A. Well, I have been in the radio business in every conceivable manner since 1924.

Q. In what capacities have you been in the radio business?

A. I had retail experience and manufacturing and wholesale departments, with field salesmen and manufacturers.

Q. In 1943 were you familiar with the companies engaged in the radio business?

A. Yes, I would say that I knew personally practically everyone in the manufacturing end of the radio business, either knew them personally or knew of them.

(Testimony of John H. Clippinger.)

Did you know of a corporation known as the Mission Bell Radio Manufacturing Company, whose name was changed to Hoffman Radio Corporation in 1943? [148] A. Yes, sir.

Q. Do you know of its operations?

A. I know of its operations, not intimately, but I knew of their lack of success, and more or less the reason for their lack of success. It was common industry knowledge.

Q. Do you know of the standing of the Mission Bell Radio Company in the year 1941?

A. They had no standing.

Q. It has been stipulated in the evidence, Mr. Clippinger, that the Mission Bell lost money in the years 1939, 1940 and 1941, and that in the year 1941 it had sales of \$29,000 and cost of sales \$30,000, and lost in that year 1941 \$15,000 from operations?

A. I didn't know the figures, but I knew that they were practically out of business when Sears cancelled out their business.

Q. It is also in evidence that on December 4, 1941 an agreement was entered into between Mr. Hoffman and the Mission Bell Radio Company whereby he was to have a three year contract, his compensation to be based on three percent of the gross sales, and in the year 1943 the stipulation shows he was paid a salary of \$8800 and commissions of some \$5400, or a total of \$63,000. As a man experienced in the radio industry, would you say that the contract which Mr. Hoffman entered

(Testimony of John H. Clippinger.)

into on December 4, 1941 was a fair reasonable contract? [149]

Mr. Crouter: If your Honor please, I object to the question, because while the witness was very well established in the field generally and in his territory and in his business at Chicago, and nationally if that embraces his territory, no sufficient foundation has been laid with the witness to show that he knew anything like the facts and circumstances which are all ready shown by the record in this case. I don't even believe the witness was in court this morning, so he doesn't know what the evidence is here. He has no conception, at least it has not been shown here, that he knew exactly what the manufacturing situation of the Petitioner was on December 4, 1941, and I submit that while I suppose this is an expert opinion, evidence on what he considers to be fair and reasonable, that there is no sufficient foundation whatever laid for him to have an opinion, and this witness can not be asked such a question in that manner.

The Court: I will let you state to this witness the facts involved here before I receive the answer. I think he should know something more about the details of it, not too much detail of course, about this company, before he answers.

Mr. Milliken: Well, it has been further stipulated, Mr. Clippinger, that this company's assets exceeded its liabilities on December 4, 1941; that it had a deficit in surplus and that it had a very small inventory of goods on hand; that [150] it was

(Testimony of John H. Clippinger.)

in default on December 4, 1941 with respect to its license fee to the Radio Corporation of America; and that it had three employees on December 4, 1941, consisting of a man by the name of Fleming who had been its directing head, and a young lady and a stock clerk. Now, that in general is the picture of the corporation's fiscal affairs as a result of stipulations and evidence of record, as I understand it.

A. I have known Mr. Fleming for many years.

The Court: Now you are repeating your interrogation?

Mr. Milliken: Yes.

The Witness: The question was do I think that was a fair——

Mr. Milliken: Well, let's rule upon it first.

The Witness: Pardon me.

Mr. Crouter: I will just make the same objection, if the Court please. I don't believe sufficient foundation has been shown yet here to show that the witness knew what the exact situation of the Petitioner Company was, and Mr. Hoffman's situation at the time, and there are a number of agreements here and things of that character that are not incorporated. It is not a proper hypothetical question. It does not fairly and completely embody the evidence in the case. I would oppose it because as it is at this moment I don't think it would be worth anything to the Court. [151]

The Court: Well, the question here is in the main a general one, as to the reasonableness of the

(Testimony of John H. Clippinger.)

salary received. This question goes to the reasonableness of this contract made, as I understand it.

Mr. Milliken: Correct, your Honor.

The Court: And the facts concerning the contract seem to me to be at least in general fairly well known to the witness. The objection will be overruled and the question allowed. You may go into that matter on cross examination, but it seems to me that he has been sufficiently informed to answer this question. Answer the question. Exception allowed to the Respondent.

The Witness: Well, I would like to answer in my own way, if I may, your Honor. I don't know anyone in the industry, including myself, that would have accepted a contract at such a low basis as three percent with more or less of a defunct company. I have seen too many radio companies in the last 20 years go broke and people who try to salvage them nine times out of ten were unable to salvage them, and the gamble is so great that if offered to me I would want at least ten percent at the minimum.

By Mr. Milliken:

Q. Then your answer would be yes, in your own judgment?

The Court: Now, he is your own witness.

Mr. Milliken: I beg pardon, your Honor. [152]

The Court: He is your own witness. Don't lead him.

By Mr. Milliken:

(Testimony of John H. Clippinger.)

Q. Well, would you say then that a contract of three percent to Mr. Hoffman represented a fair and reasonable compensation?

A. Yes, sir, I certainly do.

Q. Were you familiar in the year 1941 and in the year 1943 with the measure of compensation of executives of small radio corporations?

A. I would say I had a general knowledge of what most every executive earned.

Q. Were they compensated upon a straight salary or an incentive plan, or what was the plan?

A. In any successful company, whether they were small or large, the normal procedure was a salary or profit sharing arrangement of some type, but basically a salary, especially if they had very few stockholders.

Q. Did your company in the year 1943 have any negotiations with respect to a Washington representative, or did you have one?

A. Well, we did that earlier. In 1941 and in 1942 it was rather difficult for companies to obtain war business, and war business was going to the very large companies, like General Electric and RCA, who had very large crews of engineers [153] and we knew we were going to be washed out of the domestic business as of April of 1942, and plus the fact that we wanted to get into the war end of it, we attempted to get some war business from the army and navy. I offered one man who was in W.P.B. in Washington three percent if he would work for me in Washington. [154]

(Testimony of John H. Clippinger.)

Q. Three percent of what, Mr. Clippinger?

A. Of the total war contracts that we obtained from the army and navy. Our eventual total there was \$10,000,000 and it would have netted him over \$300,000. He turned it down for the simple reason he felt he wanted to stay in his position on the W.P.B. He didn't need the income, had a very successful business in New York City. We were solicited by a number of sales companies in Washington, sales representatives. I have numbers of their contracts on my desk, in which they were going to get us war business for a five percent premium. That was the going rate for all sales representatives in Washington, was on a five percent basis. I turned that down and I just kept on plugging. That is where I first met Mr. Hoffman, and got our own business. The only expense we had in that was a leg man in Washington which I paid \$8600 a year to.

Q. Were you familiar with the types of contracts that the Hoffman Radio Corporation had during the year 1943 with the government agencies?

A. I only know of those which Captain Shea, who was the——

Mr. Crouter: If your Honor please, I object to this. I believe that calls for yes or no as an answer, and I object to volunteering.

Mr. Milliken: Don't quote someone else. Do you know?

The Witness: I know that I found out, knew the type of equipment he was manufacturing, yes.

The Court: It is now 3:30. We usually take a

(Testimony of John H. Clippinger.)

recess at 3:30. We will be recessed for ten minutes.

(Short recess taken.)

The Court: Proceed.

By Mr. Milliken:

Q. What in general was the type of work that Hoffman Radio Company, as known to you, was performing in the year 1943?

A. Well, the type of work that Hoffman Radio was performing in 1943 would be the type of work that we didn't solicit, because that type of work entailed too many headaches, and one we avoided trying to get. We had to have very large production items, because we had 25,000 employees and a very large company, and so we rather didn't solicit too greatly these headache contracts, because it required more engineering than it did production facilities, and everyone was extremely short of engineers. Engineers were—well, they were at a premium for government contracts, for that meant that you worked on specifications and so on and so forth, and then you were on your own, and they had an engineer. If we spent the time engineering the job, we had to have large production to justify our large plant and the several thousand employees that we had.

Q. Do you know of the efficiency or lack of efficiency of the Hoffman Radio Corporation during the year 1943?

A. To my knowledge there was nothing but very glowing [156] praise for his work and his activities.

(Testimony of John H. Clippinger.)

Q. That was known to you in the radio field?

A. It was known to me. It was told to me definitely by the Navy Department.

Q. Did you know of Mr. Walter S. Harmon in the years 1942 and '43?

A. Well, yes, I have known Mr. Harmon and known of him for many years.

Q. What is his reputation as an engineer?

A. He has a very excellent reputation as one of the better engineers of the country.

Q. It is in evidence in this case that Mr. Harmon was employed by Mr. Hoffman on a salary of \$75 a week plus one percent of the gross sales.

The Court: You mean the corporation, do you not?

Mr. Milliken: What?

The Court: Employed by the Hoffman Corporation.

By Mr. Milliken:

Q. The Hoffman Corporation, paid a salary of \$75 per week plus one percent of the gross sales. In your judgment would that be a fair and reasonable compensation basis for Mr. Harmon?

Mr. Crouter: If your Honor please, I object to the question, particularly because that does not include several facts as to Mr. Harmon's employment. I don't know [157] what period or date or year counsel has in mind. It is not shown that the witness knows anything at all about the duties that Mr. Harmon did actually perform or would perform or was contemplated to perform in the future,

(Testimony of John H. Clippinger.)

and I object to the question as merely calling for a general reputation of a hearsay character, that is to say, his reputation as an engineer, as I recall it. I do not believe that it is a proper hypothetical question, or a question of any other kind at this stage of the case.

Mr. Milliken: I think we might read, if your Honor please, the contract that Mr. Hoffman actually entered into with Mr. Harmon.

Mr. Crouter: I am talking about what the record shows that this witness knows about Mr. Harmon.

By Mr. Milliken:

Q. Well, you knew Mr. Harmon personally?

A. Yes, sir.

Q. And you knew of his reputation in the industry? A. Yes, sir.

Q. And I believe you testified his reputation was excellent? A. Yes, sir.

Q. In the year 1942 Mr. Hoffman has testified that he employed Mr. Harmon as chief engineer for his corporation on a basis of \$75 a week and one percent of the gross sales. [158] A. Yes, sir.

Mr. Milliken: I renew the question, your Honor, as to whether or not this man experienced in the radio industry, knowing the man, having in mind the basis that has been laid as to what was paid and so on when the contract started on January 1, 1942.

Mr. Crouter: I still renew my objection. I don't want to be captious about this, if the Court please, but I submit that this witness has not been shown

(Testimony of John H. Clippinger.)

to have even read the contract or be familiar with it. It has not been shown that he would know what Mr. Harmon is supposed to be, merely that he is an engineer, and he is an employee of a certain man, and the record does not show——

The Court: Just a moment. The objection is overruled and exception allowed. Answer the question. You can cross examine and attack the weight of his testimony, if you wish, by cross examination.

The Witness: I consider that Mr. Harmon must have been a real gambler to accept such a low amount for his services, because I am sure that if I had known he was available I would have hired him for a great deal more money than that.

By Mr. Milliken:

Q. Your answer would be that it would have exceeded the amount the corporation would be required to pay him, a fair and reasonable compensation would have? [159]

Mr. Crouter: If your Honor please, I object to leading questions.

The Court: Don't lead your own witness.

Mr. Milliken: I will tender the witness for cross examination.

Cross Examination

By Mr. Crouter:

Q. Mr. Clippinger, how old are you at the present time? A. 49.

Q. And you have been constantly in the radio business since 1924?

A. With the exception of one year.

(Testimony of John H. Clippinger.)

Q. What year was that?

A. It was approximately 1926.

Q. Did I understand you to say it was the Admiral Radio Company that you were with?

A. Yes, sir.

Q. What is the correct name?

A. Admiral Corporation. It was Continental Radio and Television Corporation previous to that, and they changed the name.

Q. Now as I recall you started your testimony by giving us some figures regarding the business of your corporation, and I believe you stated that that was about the year 1943, where there was approximately seven and a half million [160] dollars worth of business done?

A. 1942.

Q. It was 1942? A. Yes, sir.

Q. Then if you said 1943, or if Mr. Milliken said that, you meant 1942?

A. When he asked if I had the year end statement I thought I had the 1943, but it happens to be the 1942 year end statement.

Q. Do you have a 1943 statement?

A. Not with me, no, sir.

Q. Were all the figures of the compensation of various officers you testified to with respect to the year 1942?

A. Yes, sir.

Q. Was that the calendar year?

A. Yes, sir.

Q. In your own case, as I recall your testimony, you had about ten thousands dollars worth of dividends, and that was a part of the total compensation of about \$45,000.

(Testimony of John H. Clippinger.)

A. Between forty and fifty thousand dollars.

Q. What percentage of the stock of the corporation did you own? A. Ten percent.

Q. Ten percent, and with respect to these other officers whom you mention by position, take the vice-president in [161] charge of sales. Was he a stockholder also?

A. That was me. I was, yes, sir.

Q. That was your position?

A. That is right.

Q. Take the case of the president who got a compensation of \$50,000. Was that a salary or part commission or bonus?

A. No, that was his salary only. He had approximately 60 percent of the company.

Q. 60 percent? A. He and his family, yes.

Q. And then did he receive dividends commensurate with yours on the stock there in addition to the \$50,000? A. That is right.

Q. You mentioned another vice-president in charge of manufacturing who got \$35,000. Is that straight salary?

A. That is straight salary.

Q. Was he a stock holder? A. Yes, sir.

Q. There was no bonus or commission over and above those figures that you have given?

A. No.

Q. That was the total as far as cash compensation for services?

A. As salary, yes, not for dividends.

Q. That is exclusive of dividends? [162]

(Testimony of John H. Clippinger.)

A. That is right. That is salary.

Q. Referring to the treasurer with compensation of about fifteen to eighteen thousand dollars, was he a stockholder? A. Yes, sir.

Q. And about what percent?

A. Oh, he had about two or three percent.

Q. And was that true of your secretary?

A. Yes, sir.

Q. He was also paid fifteen thousand salary?

A. Yes.

Q. What percentage of the stock?

A. He had around seven percent I believe. You were speaking of the treasurer now?

Q. The secretary.

A. Oh, the secretary. Yes, about seven percent.

Q. Then you mentioned the assistant treasurer and assistant secretary each receiving about \$12,000. Were they stockholders? A. Yes, sir.

Q. Was the Washington representative a stockholder? A. No, sir.

Q. May I see that balance sheet that you referred to. Is that \$7,500,000 figure the total of gross sales or how is that? [163]

A. That is net sales.

Q. That is after returns and adjustments?

A. Yes, sir.

Q. That was the total gross amount of business done? A. Yes.

Q. In 1942 was the Admiral Corporation chiefly engaged on domestic orders, or did it have some governmental orders for military equipment?

(Testimony of John H. Clippinger.)

A. I believe the breakdown there will show about four and a half, three to four and a half, home receiver sales and about three million government sales. It is all in here, I believe.

Q. You might wish to check the report?

A. Yes. I can't read those things.

Q. When you referred to four and a half, you meant million? A. Yes.

Q. Would it be correct or please tell the Court whether these other officers whom you have mentioned by position in the Admiral Corporation had been with that corporation for a great many years prior to 1942. A. Yes, they had.

Q. About what would they be there, about the same time or would it be different?

A. The most of them, the majority of them had been [164] there since the organization of the original company in 1934.

Q. What was the main business of that corporation? A. Manufacturing radio receivers.

Q. Did they manufacture and assemble complete units? A. Complete units.

Q. Selling to the retail trade? A. Yes, sir.

Q. On a national scale? A. Yes, sir.

Q. Some export too? A. Very little.

Q. Mostly domestic? A. Yes, sir.

Q. Some Canadian market? A. No, sir.

Q. Now, referring to the year 1943, immediately after that, how did the volume of business in 1942 compare with 1943?

A. I don't know. I can give you a guess if you would like that.

(Testimony of John H. Clippinger.)

Q. I want something a little better than a guess. You may give me according to your best recollection.

Mr. Milliken: Mr. Crouter, if I may interrupt you, please. Here is a statement for the Admiral Corporation showing the sales for all of the years, if you would like it. [165]

Mr. Crouter: I would be glad to have it. Furnish it to the witness, since we have gone into the year 1943 to some extent and I would like to ask a few questions.

The Witness: In 1943 the net sales were \$14,149,513.

By Mr. Crouter:

Q. Do you have the net sales figures?

A. That is net sales.

Q. Do you have an adjustment there showing the amount of profit, that is your operating profit merely on your sales after deducting the cost of goods against it?

A. Profit before taxes was \$1,098,633.

Q. Is that after taking all compensation deductions and all other usual and ordinary expenses of the business? A. Yes, sir.

Q. And is that figure before payment of federal taxes or afterwards. A. Before federal tax.

Q. Is it before the state tax figure, or do you have such a thing in Illinois?

A. We don't have the same thing in Illinois. We only have a corporation tax there. We don't have an inventory tax or anything like that.

(Testimony of John H. Clippinger.)

Q. Now can you tell the Court with respect to the fourteen million dollar figure approximately what percentage of that related to government orders, what if any part of it? [166]

A. 100 percent.

Q. 100 percent governmental orders?

A. In 1943.

Q. What period did you have in mind when you mentioned this hundred million dollar figure?

A. The total government contracts from the time we started our government business until the conclusion of the government contracts.

Q. Can you give us the months and years on that?

A. Well, we had \$40,679,000 in 1944, \$30,533,000 in 1945, \$31,169,000 in 1946.

Q. Referring back to 1943, can you tell the Court in a general way whether the 1943 salary schedules of the principal officers there continued through substantially the same in 1943, or whether there was any substantial change?

A. Yes, they remained the same, because we were not permitted, according to law, to make any increases. It had been our habit previous to that time in the ten years to always—every time we had a successful year we would raise salaries.

Q. Referring to your testimony regarding the positions of Messrs. Hoffman and Harmon in the Mission Bell Radio Manufacturing Company about August 4, 1941, just exactly what did you consider in your testimony here the business and the future

(Testimony of John H. Clippinger.)

business of the Mission Bell Corporation to have [167] been on December 4, 1941, in other words, its business outlook?

A. I would say they had no outlook. That would have been my opinion, sir.

Q. So that any percentage of gross would be practically nothing. Is that the way you looked at it?

A. Well, if I may explain it in my own words, I made at least four or five trips a year to the Pacific Coast contacting my salesmen, and I was in every state in the country three or four times a year, knew the radio business, had to know it in my position, and I knew that the only reason for the existence of Mission Bell a couple of years previous, that they had a contract from Sears Roebuck, and knowing that Sears Roebuck had cancelled them out, because one of our largest customers were a big account similar to Sears Roebuck, like Western Auto Supply, Kansas City, B. F. Goodrich Rubber and other large users of radios, so was very familiar with the contract business, and I knew when Sear's account was switched there was something wrong with the company if they cancelled out, and there was no hope for them.

Q. I believe you testified that you considered the three percent too low for the company as it then existed, is that right?

A. I would consider it extremely low, sir.

Q. And still you testify that is fair and reasonable compensation? [168]

(Testimony of John H. Clippinger.)

A. If I may use my own words, I think anyone would be very foolish to accept a position on that basis.

Q. That was because you considered that that corporation at that point really had lost good will and lost business, just didn't have any future?

A. That is very true. They had nothing.

Q. You didn't consider it on the basis of a company which had a potentially great opportunity with government war orders? A. No, sir.

Q. Because you yourself and apparently the Hoffman Radio Corporation didn't know there would be such a thing on December 4, 1941?

A. That is right, sir.

Q. That is the basis of your testimony?

A. That is right, sir.

Q. Would you consider three percent of gross sales or the gross amounts received and expended for government contracts which would total approximately \$14,00,000, 100 percent government orders, to be fair and reasonable?

A. Well, that wouldn't be the question at that time, sir. It would have been a question only of whether the three percent was all right or not. There were sales representatives in Washington on a five percent basis. We didn't realise that the volume would run into many, many millions. There [169] was no way of knowing that the volume was to reach that big, but if we had entered into a contract we have been obligated to fulfill it.

(Testimony of John H. Clippinger.)

Q. In other words, you just look on it as a contract entered into and you consider it fair and reasonable?

A. Well, if it failed, they would have lost nothing. That is life. That is business. It was a gamble.

Q. You had no one in the Admiral Corporation who received income of three percent that year on \$14,000,000 for 1943 business, did you?

A. No, sir. I had lots of salesmen out in the field, and I was paying them as high as five percent in 1941. I had boys who were making \$45,000 a year as commissions.

Q. This was on domestic business?

A. On domestic business. Some were drawing more than I was drawing.

Q. Had you on or before December 4, 1941 talked to Messrs. Davidge and—I will give you his full name now.

A. I never met the gentleman, Mr. Davidge.

Q. G. Gifford Davidge.

A. I never met the gentleman.

Q. Had you ever met Walter D. Douglas?

A. Yes, I had.

Q. Had you ever before December 4, 1941 discussed with Mr. Davidge, Mr. Douglas and Mr. Hoffman as to what they [170] proposed for the corporation, the Mission Bell or Hoffman Radio.

A. The question is did I talk to them before 1941?

Q. Yes.

(Testimony of John H. Clippinger.)

A. No, sir. I never knew any of those gentlemen before then.

Q. When did you first become familiar with what happened in the reorganization of this company and the change to Hoffman Radio and so forth.

A. I knew nothing about it at that particular moment. To me it was still Mission Bell. I heard about Hoffman taking it over and met Hoffman at the Navy Department many times during the course of the war.

Q. That was sometime subsequent to December 4, 1941.

A. Yes, sir.

Mr. Crouter: That is all, thank you.

Redirect Examination

By Mr. Milliken:

Q. Now, Mr. Clippinger, counsel has asked you the hypothetical question on the three percent of gross sales, looking at December 4, 1941, that Hoffman entered into this contract. If Hoffman could make that company successful, would your opinion be the same, that three percent was reasonable, whatever the sales might be.

Mr. Crouter: If your Honor please, I object to that [171] on the ground it is wholly speculative.

Mr. Milliken: Yours was just as speculative as mine.

The Court: The objection is overruled.

The Witness: Will you ask me that again?

The Court: Read the question to the witness.

(The question was read.)

(Testimony of John H. Clippinger.)

The Witness: I still think it would be a very reasonable deal for the company.

Mr. Milliken: That is all.

Mr. Crouter: No further questions.

The Court: Call your next witness.

Mr. Milliken: Mr. Tuttle.

The Court: Now is the last witness excused by both sides?

Mr. Crouter: That is correct.

The Court: The witness is excused from further attendance.

(Witness excused.)

Whereupon,

JAMES M. TUTTLE,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Tell us your name, please, Mr. Witness. [172]

The Witness: James M. Tuttle.

Direct Examination

By Mr. Milliken:

Q. Where do you reside?

A. 1084 Clarendon Crescent, Oakland, California.

Q. In what business are you engaged?

A. Presently sales manager of Motorola, Incorporated.

Q. What business is Motorola, Incorporated engaged in?

(Testimony of James M. Tuttle.)

A. We are manufacturers of home and auto radio receivers and two way communication equipment.

Q. How long have you been employed or connected with the Motorola Corporation?

A. Two years.

Q. What business were you engaged in prior to that time?

A. Two years in the United States Navy and——

Q. Prior to that time?

A. 15 years with the Radio Corporation.

Q. Radio Corporation? A. Of America.

Q. Of America? A. Yes, sir.

Q. In what business are they engaged?

A. They manufacture all types of electronic equipment.

Q. In the year 1941, what were your duties and where were [173] you stationed in your employment with the Radio Corporation of America?

A. In 1941, late in the year, I was moved from the west coast, where I had been in the continuous employ of the Radio Corporation for nearly 15 years, to Chicago, Illinois, to take up the management of distributing the products of that company in that city.

Q. What were your duties?

A. The distribution of Radio Corporation products within the Chicago area.

Q. Were you familiar generally with sales contracts prevailing in the radio industry for the sale of merchandise? A. Yes, sir.

(Testimony of James M. Tuttle.)

Q. What was the prevailing custom? Was it on a fixed salary or salary plus commission or incentive basis or what was the prevailing basis?

A. The prevailing basis at that time was a salary plus bonus or commission rates.

Q. Did it also include a straight salary plus a percentage of gross sales.

Mr. Crouter: If your Honor please, I object to that as leading.

The Court: Objection sustained.

By Mr. Milliken:

Q. Salary plus bonus and commission. What would the [174] bonuses be based on?

A. Sales or profit performance of the company.

Q. And what would the other type of compensation be based on?

A. The worth or the measurement of the man to the company at that particular time.

Q. Were you acquainted with a corporation known as the Mission Bell Manufacturing Company in the year 1941?

A. Yes, sir, as a distributor of radio products here on the coast.

Q. What was their standing, if you have an opinion in that regard?

A. Let me say not as a reputable manufacturer.

Q. And what factors entered into your conclusion of such a standing on their part?

A. Their contacts with the trade, the type of product that they built at that time, plus their financial status.

(Testimony of James M. Tuttle.)

Q. Have you heard the testimony of Mr. Clippinger who preceded you? A. Yes, sir.

Q. Did you hear the hypothetical question that I asked him with respect to the condition of the Mission Bell Radio Corporation in 1941?

A. Yes, sir.

Q. Do you have those factors clearly in your mind? [175] A. Yes, sir.

Q. Well, based upon the factors which I asked Mr. Clippinger with respect to the Mission Bell and its standing, do you consider the contract which the Mission Bell made on December 4, 1941, with Mr. Hoffman a reasonable or unreasonable contract for compensation?

Mr. Crouter: If your Honor please, I object to this. I assume that the witness probably heard the prior testimony and I believe that his testimony should be based upon things that he has learned from this record and things that he knows of his own knowledge. I don't want to prolong the time of the hearing, but I submit that is too much of a short cut. I don't believe it is a proper hypothetical question.

The Court: I think not, except to this extent: I am not sure that this witness is sufficiently conversant with what the contract contains. I think you should inform him in that regard.

By Mr. Milliken:

Q. There has been stipulated into the record, Mr. Tuttle, in this case, the letter of employment of Mr. Hoffman, whereby he employed Mr. Har-

(Testimony of James M. Tuttle.)

mon, and that letter is on a basis of a salary of \$75,000.00 per week plus 1 percent of the gross sales of the company.

Mr. Crouter: You don't mean \$75,000.00 do you?

By Mr. Milliken:

Q. \$75.00 a week, plus 1 per cent of the gross sales of the company on an annual basis, and it has also been stipulated that that contract on that same basis was renewed in the year which was ended—it was entered into January 1, 1942, and was renewed for the year 1943, and that Mr. Harmon was paid 1 per cent of the gross sales in addition to a weekly salary of \$75.00 per week, and Mr. Hoffman entered into a contract with Mission Bell on December 4, 1941, which has been stipulated and is in the record, whereby he was to get 3 per cent of the gross sales of the company plus a fixed salary, and in the year 1943 he received \$8800.00 as a fixed salary and \$54,000.00 as 3 per cent of the sales.

Looking at December 4, 1941, when Mr. Hoffman entered into this contract with the corporation, based on the facts which you have heard as propounded to Mr. Clippinger, in your judgment was that a reasonable basis for compensation?

A. Most reasonable.

Q. Do you know of the work which the Hoffman Radio Corporation did during the year 1943?

A. Yes, sir.

Q. In what manner did you learn of that work?

A. I was an assistant, I was a lieutenant and assistant [177] to the head of the production depart-

(Testimony of James M. Tuttle.)

ment of the electronic division of the Bureau of Ships, Navy Department, Washington, D. C. and thereby learned at first hand the capabilities and the facilities of all radio manufacturers in the United States.

Q. What did you learn with respect to the reputation of the Hoffman Radio Corporation?

A. The Hoffman Radio Corporation earned a considerable reputation for the Navy Department, to such an extent that they were one of our key prime contractors in later years, having earned that reputation.

Mr. Milliken: That is all.

Cross Examination

Q. (By Mr. Crouter): Lieutenant, will you please tell the court exactly where you were located or what your post of duty was on December 4, 1941?

A. I was not in the Naval service yet on December 4, 1941. I was with the RCA-Victor Distributing Corporation, Chicago, Illinois.

Q. And that was after your transfer from here east, as you have testified?

A. From the west sir, to Chicago.

Q. From the west. At that time had you met Mr. Harmon personally? [178]

A. No, sir, I did not know Mr. Harmon.

Q. Did you know Mr. H. L. Hoffman, who is involved in this case?

A. December 4, 1941? No, sir.

Q. You just knew generally of the Mission Bell Radio Manufacturing Company by reputation?

(Testimony of James M. Tuttle.)

A. And as a competitor to the products that I had charge of here on the west coast.

Q. Have you yourself read the employment contracts between the Mission Bell Radio Manufacturing Company, which later became the Hoffman Radio Manufacturing Corporation?

A. No, sir.

Q. Between the corporation and the two individuals mentioned, Messrs. Hoffman and Harmon?

A. No, sir.

Q. All you know about this case is really what you have just heard here in court?

A. Just what has been reviewed, yes, sir.

Q. You never had any official business dealings with them in 1941?

A. No, sir, not in 1941.

Q. Please tell the Court what you consider the future field of business of the Mission Bell Radio Manufacturing Corporation to have been on December 4, 1941.

A. Practically at a zero, sir, and that may be measured [179] by the fact that all the radio companies at that time were doing an exceptionally fine business. 1941 was one of our good years in the industry, and Mission Bell had fallen, both in manufacture and reputation, to probably the all-time low in their history. That is a supposition.

Q. Did you know at that time, Lieutenant, whether it had any license agreement with the RCA?

A. Yes, sir.

(Testimony of James M. Tuttle.)

Q. Did you know whether it had any contract with any of the people representing the old Mitchell Hughes Manufacturing Company?

A. Not specifically, no, sir.

Q. You didn't know anything about that.

A. Generally, not specifically.

Q. Do you know whether the Mission Bell had any contractual rights or arrangements whereby it might facilitate its continuing to do any radio business on December 4, 1941? You know nothing about that?

A. Not specifically so, no.

Q. Do you know whether the Radio Corporation of America had any contract with any high-salaried official on the basis of 3 per cent of the gross sales?

A. Not specifically, no, sir.

Q. Never heard of any such contract, did you, read about it or knew about it in an authentic way? [180]

A. Our compensation was determined by the board of directors of the company, and the amount of money that we received had no connection—it was for the executive sales management group of all types at the end of any fiscal year. That was peculiar, incidentally, to the Radio Corporation of America.

Q. Did they have sort of a bonus arrangement based on the amount of business done?

A. Yes, sir.

Q. And it would be determined near the end of the year?

A. Yes, sir.

Q. By the board of directors? A. Yes, sir.

(Testimony of James M. Tuttle.)

Q. What about the Motorola Corporation? Did it have any agreement with any high officials or officers that you knew of at the end of 1941 providing for compensation of as much as 3 per cent of the gross sales of the Motorola Corporation?

A. I would rather not be limited to the figure of 3 per cent, but the reason why I left the Radio Corporation subsequently for the Navy was because of their bonus arrangement and the volume of business done in my particular territory, and I have heard very substantial figures read off with respect to payment by Motorola, then the Galvin Manufacturing Corporation. [181]

Q. Do you know whether any of that amounted to as much as 3 per cent of gross sales?

A. I would say yes, sir.

Q. Do you know what the gross sales of Motorola would be, approximately, for the year 1941?

A. Approximately in 1941 \$9,000,000.00.

Q. Do you know who that official was?

A. There were probably a group of officials, Mr. Paul Galvin, president; Mr. Elmo Wavering, vice-president.

Q. They were also stockholders?

A. Yes, sir.

Q. Substantial stockholders? A. Yes, sir.

Q. And they were on the board of directors, I assume? A. Yes, sir.

Mr. Crouter: That is all.

Mr. Milliken: That is all.

The Court: Is this witness excused by both sides?

(Testimony of James M. Tuttle.)

Mr. Crouter: That is agreeable to me.

Mr. Milliken: Yes.

The Court: You are excused from further attendance.

(Witness excused.)

Mr. Milliken: Mr. Harmon. [182]

Whereupon,

WALTER S. HARMON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Tell us your name, Mr. Witness, please.

The Witness: Walter S. Harmon.

Direct Examination

By Mr. Milliken:

Q. Where do you reside, Mr. Harmon?

A. 4025 McClung Drive, Los Angeles.

Q. In what business are you now engaged?

A. Engineer and sales representative. I represent approximately 10 eastern companies in an engineering and sales capacity on the coast.

Q. Are you in business for yourself or are you employed?

A. I have what is known as the W. S. Harmon Company.

Q. What business is that engaged in?

A. Well, it is, as I say, engineering and sales representation.

Q. How long have you been so engaged in that business? A. Since June of 1946.

(Testimony of Walter S. Harmon.)

Q. Where were you employed, if you were, prior to June, 1946? [183]

A. Immediately prior to June of 1946?

Q. Yes. A. Hoffman Radio Corporation.

Q. How long were you employed by the Hoffman Radio Corporation?

A. From January of 1942.

Q. To June of 1946? A. That is correct.

Q. How long have you been in the radio engineering business, Mr. Harmon?

A. My first recollection as an engineering capacity would be in 1926.

Q. Will you please start in 1926 and bring yourself down to January of 1942, your employer, if you had an employer, your position, if you had a position, your compensation and your duties?

A. Well, in 1926 I was engaged as a radio engineer in the research laboratory of the Music Master Corporation, Bettswood, Pennsylvania. I was there until April of 1927. My salary, I believe to be around \$35.00 a week at that time.

Q. What business were they engaged in?

A. Radio manufacturing.

Q. Then you were there, you say, until 1926?

A. 1927.

Q. 1927. [184]

A. In 1927 I went with the Distanttone Radios, Incorporated, in Linn Park, Long Island. My duties there were in charge of engineering and also some production supervision, and my salary there, as I recall, was in the \$40.00 to \$50.00 bracket, as I recall. I started at \$40.00 and later received \$50.00 a week, that is.

(Testimony of Walter S. Harmon.)

Q. Were there any people under your supervision while you were working at the Distanttone Radios Company?

A. Distanttone, yes. We had approximately, I would say, 25 to 30 employees, and the majority of them reported to me.

Q. When you ceased working for Distanttone, then who were you employed by?

A. Distanttone then took over the bankrupt company known as the A. C. Electric Company of Dayton, Ohio, and reorganized it to the A. C. Dayton Company, and that was in 1927, I don't remember what month, and I went to Dayton with them in charge of engineering.

Q. What business were they engaged in?

A. Manufacturing radio receivers.

Q. Were there people under your supervision there?

A. Well, we had a larger organization there. I had three men under me in the laboratory there. The salary was, as I recall, \$50.00 a week.

Q. How long did you remain with that company? [185]

A. Until 1928.

Q. Whom were you next employed by, if you were?

A. In 1928 I went with the Dayfan Electric Company in Dayton, Ohio. They were engaged in the manufacture of radio receivers, as well as electric fans and motors. I was in an engineering capacity there. Again I had anywhere from two to three engineers reporting to me at the time I went there. The salary, however, was lower there. As I

(Testimony of Walter S. Harmon.)

recall, I started for \$35.00 a week. Dayfan Electric Company about a year later was taken over by the General Motors Corporation, or rather a new corporation was formed which was known as General Motors Corporation, General Motors owning 51 per cent of the stock and Radio Corporation of America 49 per cent, and that was a \$10,000,000.00 corporation.

We had an engineering department of approximately 65 people. I had various jobs there, heading up design groups. I first had what was known as the radio frequency group, that were involved in the development of the radio frequency portion of a receiver, later headed up the advance development group, with four engineers reporting to me, and later headed up the household receiver division, in which I had all engineers reporting to me responsible for the design of household receivers. General Motors Corporation manufactured both household receivers and automobile receivers.

Q. How long did you— [186]

A. That was 1932, as I recall, February of 1932.

The General Motors Corporation ceased operation at that time, and I went to Chicago and was employed by the Zenith Radio Corporation in charge of automotive radio receiver design. I had three engineers reporting directly to me, and inasmuch as Zenith was a rather finely integrated organization, that is, they had a drafting department, metal shop and so forth—the design groups took advantage of those facilities, and at Zenith I re-

(Testimony of Walter S. Harmon.)

ceived, my memory is not clear, either \$60.00 or \$65.00 a week.

While at Zenith I developed what was then known as the first single auto radio, that is where the receiver and speaker and power supply was all contained in one unit. In the development of such a receiver I developed means of suppressing vibrator interference, which had precluded the use of self-contained power supplies up to that time, and as the result of that, and the Zenith Company being in a rather hard financial position in 1933, I went with the Utah Radio Products Company as a field engineer.

My duties there were to contact the various companies that Utah sold components to. They were engaged in the sale of radio components that they used, and it was my duty to try to acquaint engineers with our components and also help them in the application of the components to use on their products, their products in each case being [187] automobile receivers. My compensation, as I recall, at Utah was the same as I received at Zenith, and as I say, my memory is not clear, either sixty or sixty-five, a week, from Utah Radio Products. That brought us up through 1933, didn't it?

I went with General Household Utilities in the automotive receiver division as project engineer, having approximately three engineers reporting to me at that time. The work which I was concerned with was the design of automotive receivers. During that period General Household Utilities was sole supplier of automotive receivers to the General

(Testimony of Walter S. Harmon.)

Motors Corporation, which included Buick, Olds, Pontiac, and also the United Motor Service group. My mind is not clear on what my salary was, but it would have been at least what I made at Utah.

In 1934 I went to work for Emerson Radio and Phonograph Corporation in New York City, who were engaged in the manufacture of home radio receivers, and after a short period I became chief engineer. I headed up their entire engineering activities at a salary, as I recall, which started at \$75.00 a week and later that was increased slightly, although I don't recall the figures.

Q. Emerson Radio, in what business were they engaged, manufacture of radios?

A. Radio receivers, yes. They are a nationally known [188] organization. At that time our peak production was in the neighborhood of 4000 receivers a day.

Q. 4000 a day?

A. In 1936 I came with Mission Bell Radio Manufacturing Company in Los Angeles, again to head up engineering. However, my duties were somewhat broader there, it being a small company, and I also did a certain amount of production supervision. My salary there was on a basis of \$50.00 a week and 10 cents on each receiver sold.

Q. In other words, you got, in addition to the \$50.00 a week, 10 cents for each set sold?

A. That is correct.

In 1940 I went with Mitchell-Hughes Company, what became known as the **Mitchell-Hughes Company** headed up by a gentleman by the name of

(Testimony of Walter S. Harmon.)

Alex Hirsch whose program was to develop and manufacture a high-quality radio phonograph combination. When I went with Mr. Hirsch he agreed to give me 50 per cent of the net profits of the company, without any capital investment on my part. My compensation there initially, as I recall, I went in on a consulting basis and then later went in at a salary of \$100.00 per week, with the understanding that I was to receive 50 per cent of the net profits, and also I was to receive stock in the company, upon its incorporation.

Unfortunately, Mr. Hirsch died before that ever was concluded, with the result that I operated the Mitchell-Hughes Company for the estate of Mr. Alex Hirsch until 1941, just in the latter part of 1941, at which time it was decided to liquidate, and I left and was trying to find a location when I was approached by Mr. Hoffman on joining the then Mission Bell Radio Manufacturing Company.

Q. When did Mr. Hoffman, if you remember, approach you with respect to joining the Mission Bell under his leadership?

A. Well, it was, I believe, December of '41, 1941.

Q. Did you have a discussion with him with respect to prospective employment with his corporation?

A. Yes, we had quite a discussion. Mr. Hoffman approached me on the matter and, as I recall, we had two discussions. I was not very enthusiastic about it, due to the fact that I knew the

(Testimony of Walter S. Harmon.)

problems of the Mission Bell Company, having been with it, and also seeing in the years after I had left its gradual depreciation, and I could not see where we had much to go on, so I was not very interested the first time.

After further discussion, Mr. Hoffman outlined his ideas, also the fact that he had Mr. Davidge and Mr. Douglas who could lend financial support to any program that we would go into, within reasonable limits. Mr. Hoffman's ideas intrigued me, and the result was I entered [190] into the contract which has been stipulated here.

Q. And what was that contract?

A. A salary of \$75.00 a week and 1 per cent of the gross sales.

Q. At the time you and Mr. Hoffman discussed that agreement, did you discuss any other means or types or bases of employment?

A. I was not interested in anything other than an incentive program, because that would be the only thing that would be reasonable. Obviously Mission Bell Company at that time was in no position to pay a salary such as I was entitled to, so that the best way for me would be to be on an incentive basis.

Q. I understand you to say that would be the only basis upon which you would have accepted it?

A. That is essentially correct.

Q. Is Mr. Hoffman related to you by blood in any way? A. No.

Q. Or by marriage?

A. Not that I know of.

(Testimony of Walter S. Harmon.)

Q. Do you own or have you ever owned any stock in Mission Bell or in Hoffman Radio?

A. No, sir.

Q. In the year 1943, you owned no stock in the Hoffman Radio Corporation? [191]

A. I did not.

Q. As I understand it, then, you agreed with Hoffman in January of 1942. Did you then begin work for the Hoffman Radio Corporation?

A. Yes.

Q. And did you remain in their employ in 1942?

A. I did.

Q. And in the year 1943? A. I did.

Q. Did you have any other employment in either of those years? A. No, sir.

Q. You devoted your entire time to their affairs, is that correct? A. Yes.

Q. And during that time, during 1942 and 1943, you were the chief engineer of the corporation, is that correct?

A. I went in originally, I believe, as chief engineer, and later was appointed vice-president of the company.

Q. I show you a book entitled "Hoffman War Time Radio Equipment," and I will ask you if you can go through that book and the various inventions or contracts that the Hoffman Radio Corporation had during the years 1942 and 1943, explaining what you did with respect to each invention and the novelty of the invention, if there be such. [192]

(Testimony of Walter S. Harmon.)

A. I wonder if I might have permission to define an engineer's duty in a corporation of this size?

Q. Well, you can define your duties. What were your duties with the Hoffman?

A. A lot of people think that engineering ability is reflected by the patents held. I as an engineer, having spent all my useful life, you might say, in this business, never considered engineering as resulting in patents. I have a couple of patents of my own, but I do not think that they represented a great contribution to the art on my part. An engineer's duty is to make something, a product which you choose to manufacture, to take art which is already known and develop a product.

Now, in the development of that product there may not be anything of a patentable nature. However, it is a very vital part of developing its product for the company. Now, take like this variable condenser which has been discussed, the variable condenser contracts. I don't think there is anything patentable on the thing. However, it was a component which was needed very badly by the Bendix Aviation Corporation. The known condenser manufacturers at that time would not have anything to do with it. It is a difficult item to produce. I believe Mr. Hoffman stated that the plates on this thing are soldered into the shaft, whereas, the normal means was to put them on there and swage them, or in cases assemble [193] them with spacing washers. The fact that the condenser was made out

(Testimony of Walter S. Harmon.)

of brass and due to the conditions under which it had to operate you had to solder those plates on, so brass being a very good conductor of heat, you could not get the solder to flow and to weld these plates onto these shafts. So rather than spending engineering time on developing a unit, we had to spend engineering time on developing procedures to manufacture this unit.

As an example of this, we knew that we could not apply enough heat with a soldering iron to bring those up to temperature, because brass being a good conductor of heat took the heat away almost as rapidly as you put it in there. The way this was finally accomplished was through development of jigs, taking it over a heated flame, the jigs were hot enough they were practically at soldering temperature, just below soldering temperature, and the final operation was performed with special irons that we developed to use to apply the heat in the right places for the soldering. After the soldering was through, then the iron was taken away and they remained to the point of where the solder solidified and then they were removed from the jigs, and that is the type of engineering which went into anything like this.

Another case was——

Q. May I interrupt you there, Mr. Harmon? You had the specifications from Bendix, did you not, with respect to [194] what they wanted?

A. That is right.

Q. Was it a job, then, on your part of merely following those detailed specifications?

(Testimony of Walter S. Harmon.)

A. Oh, no.

Q. What was your task to deliver the completed article?

A. Well, the specifications covered a condenser. In other words, it gave the capacity range, gave us the capacity of the condenser and gave the physical size and the application of the condenser.

Now, it is true we had drawings on the plates and we knew the plate shape and we knew the end plate design and so forth, but that was the smallest part of the job. As I say, the job was to develop methods whereby they could be produced.

Q. Did you do that at Hoffman Radio?

A. We had to do it, Mission Bell Radio at that time. As an example, those plates on this condenser were all gold plated. Well, there were no gold plating facilities in the Los Angeles area for handling units of this type. Normally the gold plating operation is for costume jewelry, usually small items. Here we had pieces of equipment it was very difficult to apply gold plating to. It was very difficult to do in between the plates and we had to work with organizations—as a matter of fact, we found no established gold [195] plating organization to do this job, but we found an electro plater, discussed our problem at great length, gave our own ideas as to how it could be accomplished, and this one supplied plating facilities to produce it for us.

Q. Will you take another typical contract which you had during the years 1942 and 1943 and explain it briefly to the Court, having in mind the

(Testimony of Walter S. Harmon.)

contribution, if there was such, by you as the chief engineer and by the Hoffman Corporation?

A. Well, the kite, I think, was a good example. After all, there was no knowledge as to building an antenna kite which would satisfy those requirements. The purpose of the kite was to lift approximately 300 feet of wire into the air to serve as an antenna for this rescue transmitter previously described.

The kite was therefore to be very efficient, since it would have to be launched from a life raft in the ocean. The stipulations were that the kite should be able to be launched from a life raft in a wind velocity of seven miles an hour. That is very little wind. Also, the kite had to withstand winds in the neighborhood of 45 miles per hour, which is a very destructive wind. The specifications given, that Bendix had on this kite, the kite could not have been produced. I think we made many contributions to this. The original kite used chrome molybdenum tubing, which is very [196] difficult to fabricate and very difficult to procure. During the process of these contracts we developed the use of stainless steel tubing.

Also the original plans were to have this kite in one piece, which required storage in a cardboard container approximately 3 inches in diameter, and since the thing, as I recall, was 36 inches long, the tube was that long, it was rather inconvenient to pack into an airplane, so we evolved means of putting the kite in two sections, which resulted in put-

(Testimony of Walter S. Harmon.)

ting it in a tube approximately 18 or 19 inches long, packing the container with 6 tubes forming the skeleton work of the kite.

One of the requirements of this kite was that if you attempted to launch it and you hit a down-draft and it hit the water, it was supposed to float. The kite cloth was waterproofed. In addition, it also had small boxes of kapok in it to make it more buoyant. However, the tubes themselves would take in quite a lot of water. There were rather elaborate ideas on that. One was to stuff cotton down each end of the tube and pour hot wax down, which was purely impractical from a production standpoint. It was accomplished merely by using small corks, which sounds simple now, but meant doing at the time something nobody ever heard of.

We also developed clips for holding the cloth onto the tubing, which was quite a factor in the production of a [197] good kite. Originally it was thought that they could be put on with small clips that were soldered on these bars, through the cloth and pinned it there. That was not good due to the fact that it would puncture the cloth with it when the cloth was put on, besides they were too delicate to be soldered onto the main tubing. As the result I personally designed the present or the final form of clamp which holds the cloth on there. That is an example. I mean, undoubtedly one could have obtained a patent on that clamp, but what value the patent is, I don't know, because I don't imagine very many people are using those peculiar types of kite today, but this was an example of a project

(Testimony of Walter S. Harmon.)

that they undertook on which there was no prior art to go back to. I mean you could read all the articles in the world on box kites and you still would not find anything saying how to build a kite to serve this purpose.

Q. Now, you are relating this only to the years 1942 and 1943, aren't you, Mr. Harmon, the things that you have explained?

A. Yes, that is right. We developed what was known as the A-62 phantom antenna, which went into tanks, reconnaissance cars and so forth, the purpose of the antenna being to allow the adjustment of a transmitter, final adjustment of a transmitter without radiating a signal.

I might explain a radio transmitter cannot be just [198] turned on and you start transmitting. There is a warm-up period and final adjustment of frequency and so forth, and in combat areas, of course, they don't want any signal on the air until they are actually ready to shoot, which means that you had to have means of doing this adjustment on the transmitter, and that was the purpose of the A-62 phantom antenna. That was worked out in conjunction with the U. S. Signal Corps laboratory at Fort Monmouth. There we had drawings available. However, they were more to indicate a principle rather than a final design. It was our job to design the unit which could be produced in production quantities to meet the specifications as set up by the U. S. Signal Corps. That again, I think there was **nothing obtainable on it. Certainly** if there was, no one bothered about it, but there were

(Testimony of Walter S. Harmon.)

techniques developed for the production of that unit, much the same as in the variable condenser.

In the same way we also produced what was known as the A-58 phantom antenna, whose function was the same as the A-62. However, it was for a much different type of transmitter. It was for ground stations and so forth. There again we were given a design. However, due to material shortages and time the design could not be reproduced, so it was necessary to redesign into materials that were available. As an example, the front panel and so forth were made of aluminum on previous models. We went to steel, with proper finishing to prevent rusting, which incidentally was to meet [199] salt spray specifications and so forth of the Army. On that unit we also developed local sources and worked with them on the steatite components which went into it. We also tooled completely for the parts that went into it, that is, all the mechanical parts.

Some of these I can't remember the contract dates. I do know that we entered into a contract with the U. S. Navy in 1943 for LM type frequency meters. At that time there was a very serious shortage of the frequency meters. They had one source of supply in Maryland, who were very considerably behind on deliveries. The LM frequency meter, I might point out, is the equipment that was used as a frequency standard. The purpose of it was to allow the accurate adjustment of frequency of either a transmitter or receiver for communication

(Testimony of Walter S. Harmon.)

purposes. It was a very difficult piece of equipment to build. Each individual instrument had 4000 calibrations, any one of which had to be within 1/100th of 1 per cent accuracy, 1/100th accuracy is very difficult to attain, and not only that, it had to maintain that accuracy throughout a temperature range of 35 below zero to 65 degrees—I am speaking of the centigrade scale now. That was precision manufacturing, and there again there is very little that you could obtain on it.

The original piece of equipment had been evolved during World War I, and it was rather to find out how we could [200] produce in mass quantities precision equipment. This equipment had to be produced in large volume at accuracies greater than the average laboratory equipment that was used. As an example, the variable condenser which is attached to the dial in the equipment had a gear train on it in which the accuracy required on backlash, which was lost motion in the gears, was five times greater than the usual precision condensers which were used as laboratory standards, yet we had to maintain that accuracy in order to meet the final specified accuracy of the total equipment. That took a great deal of work with outside suppliers, particularly machining facilities. We also had to develop inspection facilities for the components when they came in to determine if they were within our required accuracy.

Q. If I may interrupt you, Mr. Harmon, there has been Exhibits 3 and 4 introduced. I show you a

(Testimony of Walter S. Harmon.)

copy of them, the orders in each of the years, which may help you in explaining the work which you handled as engineer.

A. Well, I notice there is on here—would you like to continue with this frequency meter discussion?

Q. Yes.

A. The frequency meter itself had to use a standard of frequency, which was a crystal. The crystal accuracy had to be maintained at 1/10,000ths of 1 per cent. The original supplier of the equipment had waivers on Navy inspection that [201] allowed the equipment to go out by a specified tolerance in case it was tilted. That meant if it was in an airplane and if the airplane went in a bank at the time the operator was trying to set the frequency, he would have been off frequency. Through working with a laboratory here which had never produced crystals, however, they did know quite a lot about quartz, we evolved a design which maintained its accuracy regardless of position, so in the end result our equipment was more stable and more accurate than that previously purchased by the government.

There was another serious matter in this particular piece of gear, in that any component used in our equipment had to be electrically and mechanically interchangeable with that produced in Maryland, yet we could not use the same suppliers. As I recall the contract, we had to—I do not know the exact percentage, as I recall it was 60 per cent of the components from west coast suppliers. There

(Testimony of Walter S. Harmon.)

was scarcely any of those components that were standard equipment with our normal component suppliers, which resulted in most of our engineering time being spent helping our suppliers produce the components for us.

The frequency meter, as I recall this thing, was tooled and produced in approximately six months, whereas other suppliers on the same type of equipment, not necessarily the same thing, but in the Army frequency meter, had spent [202] a year, a full year in putting it into production at a much higher cost, and inferior inspection equipment. Also there was a complete series of LM frequency meters produced, LM-14 for airborne equipment, LM-15 for land stations, LM-16 for reconnaissance groups or landing operations and the LM-17, which was the panel model, which was for use in the field office.

In the development of this equipment the main problem was calibration. I took, as I say, three to four thousand calibrations on each equipment, and they had to be within a specified accuracy of 1/100th of 1 per cent. The equipment, incidentally, covered a range of 125 kilocycles to 20 megacycles. In order to calibrate it we had to—the calibration had to be based on a given temperature, because a few degrees change in temperature would obviously change the calibration of the instrument. The stipulated temperature was 20 degrees Centigrade, which was 68 degrees Fahrenheit, so we had to produce a room which would accommodate any number of people from 1 to 20, the room had to be main-

(Testimony of Walter S. Harmon.)

tained at that temperature within 1 degree, and more than 1 degree variation in room temperature would have thrown the calibrations off, and as I say, where you have 20 people, people move, leave the room or come in, it is very hard to maintain such a temperature. It was accomplished, with a great deal of time and effort given to it. [203]

Then the previous supplier of this equipment had approximately \$200,000.00 worth of equipment for generating test frequencies. Obviously, we could not do that, at least if we were going to get frequency meters in any reasonable period of time, so we evolved different methods of producing our standard frequencies which allowed us to maintain calibration to only one frequency standard which was checked practically hourly with the Bureau of Standards Station WWV at Washington, which puts out the standard frequencies. We developed the means of piping those frequencies to the various test positions set up with equipment where the calibrating could be done by girls merely after a short period of instruction.

I might point out that, as I say, there were 4000 calibrations on the instrument. 400 calibrations were actually recorded on each instrument by the girls, and we in working with the adding machine helped evolve a tabulating machine which would interpolate the 400 figures which we gave it into 4000 and still maintain accuracy, and that, of course, resulted in a saving to the Navy Department in the building of the equipment and getting the equipment out.

(Testimony of Walter S. Harmon.)

Q. How much did that reduce personnel from what had been required prior to that to do it with?

A. I can't answer that. I did know the figures, but I am sorry, I don't know. [204]

Q. There was very definitely a great reduction, did you say?

A. Yes. Normally those 4000 figures were all typed in on a typewriter. This equipment was put on an adding machine, and you see the girl put the first significant figure in on the adding machine with the next, pulled it, and then would pull it down ten times and it would automatically print the correct figures in there, so a girl could print a tape on one of those machines in 25 per cent of the time that it would have taken by a typewriter.

Q. Mr. Harmon, would it be accurate to say that in the years 1942 and 1943 the Hoffman Radio Corporation was not a mere assembler of parts—I will withdraw that.

Go ahead and explain the rest of the inventions.

A. Well, the frequency meter was the largest product—the largest project, I think we entered into with the government. It was the most difficult one, certainly, and as the result of our work the frequency meters finally came off the critical list, and subsequent contracts were on a competitive basis. We received the greater percentage of them from the Navy Department. I believe that we also refunded to the Navy Department some money even on the original contract.

The Court: It is now a quarter past 5:00. Can you give me any idea as to how much more time

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you will take? I am not hurrying you now at all. This is not the kind of a [205] case to hurry, I think.

Mr. Milliken: Well, I think I can shorten this witness' testimony and that he will not go through all of these things only generally to show the contribution of the corporation. I figure that it will probably take another half day, at that. I have only one more witness that will take probably not more than an hour or two hours.

Mr. Crouter: I estimate about two hours for Respondent's witness on direct.

The Court: I judge from that then that it will take at least all day tomorrow.

Mr. Milliken: I think that would be a fair guess, if Mr. Crouter will take two hours with his case.

The Court: Is there any reason why we could not start at 9:30 tomorrow morning?

Mr. Milliken: It would be all right with me, your Honor.

Mr. Crouter: Agreeable to me.

The Court: We will start at 9:30 tomorrow morning. We will be recessed at this time until 9:30.

(Whereupon, at 5:15 p.m., an adjournment was taken until 9:30 o'clock a.m., Friday, December 12, 1947.) [206]

(Testimony of Walter S. Harmon.)

December 12, 1947

The Court: Proceed.

Whereupon,

WALTER S. HARMON

called as a witness for and on behalf of the Petitioner, having been previously duly sworn, resumed the stand and testified further as follows:

Direct Examination (continued)

By Mr. Milliken:

Q. Mr. Harmon, I believe at the recess yesterday you were endeavoring to inform the Court of the matters in which the corporation was engaged during the years 1942 and '43, particularly with war contracts, either prime or subcontracts.

A. I believe I covered variable condensers, kite, the A-58 phantom antenna, A-62 phantom antenna, and the LM frequency meters.

We had an item which was known as the noise peak limiter adapter. If we want to speak of inventions or original design, that definitely was, including constructing a complete unit which was conceived by us in its entirety. The purpose of the equipment was to limit noise peaks on communication receivers. The theory behind it was by certain circuit configurations we could make the receiver respond to wave forms of pure sine wave, which normal communications signals are. Noises are random wave forms; by that I mean [209] they are not a pure sine wave. I don't know whether anybody knows what a pure sine wave is or not, but,

(Testimony of Walter S. Harmon.)

anyway, that is a wave of uniform shape, whereas noise peaks are a random form. To put it plainly, the idea was that you could not take a square block and put it through a round hole.

Now, that is essentially what the noise peak limiter was. As I say, it was originated by Hoffman Radio Corporation and submitted to the Navy Department and subsequently ended up in a small production contract, I believe the figure was 2280 units.

We also produced along that same line an electronic relay. Again the purpose of the relay was to limit noise. That was adaptable only to communication receivers, not receivers using voice frequencies, but rather code frequencies or code signals, I should say. That was developed by us and offered to the Navy Department as a new development. It was very effective. Tests at the Naval Research Laboratory indicated that noise reduction was in the order of 120 decibels. 120 decibels means that that was a million to one ratio. In other words, to give the same amount of sound from the receiver the noise had to be a million times stronger than the desired signal, which for all practical purposes means there was no noise, in that your ear could not differentiate between a million to one ratio in sound. There was a great deal of pure development work went into that [210] device. It did fill a need. The Navy Department first issued a development contract to produce 10 of these units. I don't recall just where they were sent. I know of one unit that was sent into the Alaskan area, where they were

(Testimony of Walter S. Harmon.)

troubled with very heavy static, another went into Honolulu, which was another noisy area, I believe one went into Florida; the rest of the 10 I am not sure where they went, but anyway they were shipped into areas where noise was a factor, and the field tests showed that the instrument was very effective. I think later that ended up in a production order for a redesigned unit. However, it does not come into the period with which we are concerned.

On this noise peak limiter we also developed, as I recall, three different types. One was made as an accessory for the Navy—I believe it was the RAS receiver. Another one was made for the SX-28 receiver. Still another one was made for the ARB. The purpose of all of them was the same, just a matter of adapting them to receivers.

Now, that was an accessory that could be sent out into the field where they had noise and they had a certain type of receiver. This adapter could be plugged into the receiver, and it was very effective in reducing noise, which means that communication was made possible in some cases where it would not have been otherwise.

Another contract which was—a great deal of engineering went into it—was the electronic firing error indicator. That was a program that was coordinated through the Office of Scientific Research and Development with California Institute of Technology. In that case we were developing equipment which was—came from a theory that had been evolved by some of the California Institute of

(Testimony of Walter S. Harmon.)

Technology group. The purpose of it was for training aircraft gunners. In normal aircraft training they had used—the bullets in the machine guns or anti-aircraft guns would be coated with different colored paint and they would fire at the target, and after the target was dropped they could register the amount of hits which the gunner had made.

However, the purpose of this was to develop a means of giving immediate information to the gunner and the officer in charge of training, to know whether the gunner was leading the target, whether he was hitting it or lagging it, or whichever the case was. It was a very involved piece of equipment, involving the development of a small transmitter which could be carried in a sleeve target or a flag target, whichever the case was. The theory of it was that the transmitter was of the frequency modulated type, had a microphone in each end which would correspond to the front and the rear end of the target. The microphones were calibrated to indicate the distance that the projectile was from the microphone. That extended over a long period of time. It involved [212] considerable tests at Camp Irwin out here in the desert. It was hard to co-ordinate the development of it, because there was so much time involved in arranging for planes to carry the target. It also had to be co-ordinated with the regular training program at Camp Irwin. The ammunition had to be provided from Washington, the planes from Riverside, and, of course, tests out at Camp Irwin, which meant there were three groups that had to be co-ordinated

(Testimony of Walter S. Harmon.)

and it usually took about 30 days to arrange for a test. A test might last an hour, and then you would wait another 30 days in order to retest again. That did end up in a production contract from OSRD, as I recall, in the neighborhood of a thousand of the small transmitters, and I believe five or six of the main receiving stations. I could be slightly in error in those figures. However, I think they are close.

We also handled the complete development of an antenna coupler for the Navy Department. The design was made by us from a mere specification drawn up by the Navy Department; by specification I mean they required a piece of equipment to do a certain job. They did not furnish drawings of the equipment, did not furnish circuit diagrams. In other words, the specification merely indicated the type of equipment that they wanted and the physical area available for the equipment to go into, so it was a complete design. That was for a quantity of 300 units. Now, the engineering is just [213] as difficult to produce 300 units as to produce 3,000,000 units. However, it was a service that someone had to perform, and we did it.

Another unit of somewhat the same category—or I might explain the purpose of the antenna coupler. It was for use at ground receiving stations where many receivers were used, and in order to eliminate the necessity of putting up an antenna for each receiver. This could work from one antenna and coupled, as I recall, five or six receivers to one antenna, and the receivers could operate independent of one another. And there was no interaction occurred.

(Testimony of Walter S. Harmon.)

Now, another unit of somewhat the same category was the audio coupling unit. There were only 50 produced. However, the development was a design, was handled from a specification which merely indicated the need for a certain piece of equipment. That unit allowed the one monitoring officer to follow, again I think it was either five or six receivers. In other words, it had trigger tubes in it which would light up indicating a channel was in operation, and he could then tend that one channel.

I think I have covered most of the equipment.

Q. And the recitals that you have made, both on this morning and yesterday, relate to work, engineering work performed by the Hoffman Radio Corporation during the years 1942 and 1943? [214]

A. That is correct.

Q. Did you have engineering work initiated in, we will say, the year 1943 that related to actual production at a period subsequent to 1943?

A. Oh, yes, we must have had the LM frequency meter. A great deal of the government production was handled—I mean we produced that equipment all during the war, even some after V-J Day.

Q. If I understood your testimony correctly yesterday, in many instances it might be necessary to engage in a great deal of pre-engineering work, and the actual exploitation for manufacture of the finished product might occur at a subsequent time.

A. That is correct.

(Testimony of Walter S. Harmon.)

Q. Would that be true with respect to the year 1943, of articles manufactured, we will say, and delivered in the year 1944? A. Yes.

Q. What condition did you find the work shop, tools and inventory and so forth of the Mission Bell when you started to work there in January of 1942?

A. Well, the organization, as has been pointed out in previous testimony, was pretty much dormant. The inventory to a great extent was obsolete inventory, by that I mean the parts had little value as far as any new equipment. There was [215] very little equipment to work with. As I recall, we had one signal generator which was the major piece of test equipment. There were—oh, probably a volt meter, a few hand tools, but there really wasn't very much to start with.

Q. How many employees were there when you began work in 1942?

A. Well, as I recall, it was four, I think was the number.

Q. What was the type of work that they performed? Were they engineers?

A. The girl—no, no, there were no engineers there when I went there.

Q. Then did your engineering staff grow during the years 1942 and 1943? A. Yes.

Q. Will you just briefly detail the progress of the growth of the engineering staff? As I understand it then, all engineering work was under your direction.

A. That is correct, also the inspection division was under my jurisdiction. Well, as I recall, we

(Testimony of Walter S. Harmon.)

started on this same civilian receiver development in order to get immediate business, also acquired the inventory of Mitchell-Hughes Company, which gave us a start. Then I engaged one engineer to assist in that, and later as we got into these various military contracts we kept building the personnel up, [216] I mean engineering personnel, such as draftsmen and junior engineers. I can't quote figures, I don't know. I would say at the end of 1943 we probably had 20 people in engineering, and that, as I say, is just an estimate.

Q. I show you part of the stipulation in this case, Mr. Harmon, and I refer to Exhibit 20 attached to the stipulation and this schedule reflected by Exhibit 20 set forth all employees with their classification, employed by the Hoffman Radio Corporation during the year 1943, other than those employees who worked upon an hourly rate. I will ask you to please examine that exhibit and tell the Court the number of engineers reflected thereon and generally what were their duties.

The Court: So far as the number is concerned, it designates which ones are engineers there, doesn't it?

Mr. Milliken: Yes, it does, your Honor.

The Court: Unless there should be some who might be engineers and not so designated.

Mr. Milliken: Well, I think it might be a matter of computation.

Q. (By Mr. Milliken): Mr. Harmon, go through this, the exhibit speaks for itself, but

(Testimony of Walter S. Harmon.)

would you please look at all persons who are designated as engineers and tell us generally what work they performed? [217]

A. Do you want me to define the classification? Is that what you mean?

Q. Yes, and the work they performed.

A. I find the figures incidentally are slightly in excess of the 20 that I estimated. Well, we have the classification——

Q. You will note, Mr. Harmon, in order that you might not be on a wrong tangent there, we have starred that exhibit and there are some who were there only a portion of the year.

A. Oh, I see.

Q. In other words, an engineer might have been there six months and left and another engineer took his place.

A. I see. Well, we have the classification of junior engineer—perhaps I should have started at the top. We have section engineer. A section engineer may have been assigned a complete project, in other words, we will take the antenna coupler as an example. We will assign that to him. He was responsible for the following of that thing through the design stages and putting it into shape for production. I mean, not only the equipment, but also in the following drawings, bills of material, and so forth. He would have—depending on the project, he would have a senior engineer probably reporting to him. The senior engineer was usually, if we could get them, an engineer that had previous designing

(Testimony of Walter S. Harmon.)

experience, perhaps not on handling [218] a complete project, but some phase of it. He may have been a mechanical engineer. He may have handled only the chassis designs or so forth. A junior engineer was usually someone who had had engineering training, but he was more just somebody to do the labor work for the other engineers. A draftsman, of course, is self-explanatory, made the drawings under the supervision of any of the engineers of the project.

The Court: You just asked him about engineers, didn't you?

Mr. Milliken: Yes, Your Honor.

The Court: Yes, that is what I thought.

Q. (By Mr. Milliken): Did you supervise the work of all persons who were designated as engineers on the exhibit which you have before you?

A. Yes.

Q. And what was the extent of that supervision? I mean by that, did you lay out the work for them and did you direct what they should do?

A. Well, depending on the nature of the project and the capabilities of the men that you had available. I naturally supervised the entire engineering activity and would, particularly on equipment such as the LM frequency meters I contributed a great deal myself to them as to outlining how I thought the equipment should be produced. Of course, in engineering [219] a piece of equipment, you break it down into the various sections of the equipment, and you would have different men on it, and you would assign the project to them, and wherever pos-

(Testimony of Walter S. Harmon.)

sible I would outline how I thought it should be accomplished.

Q. I believe you testified yesterday that you gave your exclusive time and attention during the year 1943 to your employment by Hoffman Radio Corporation, is that correct?

A. That is correct.

Q. Are you able to approximate the number of hours per day you were worked during the year 1943?

A. Well, it seemed to me I worked all the time. My home was within about eight or ten minutes from the factory. I always went back at night, and I doubt if there was any Sunday during that period that I was not at my office, probably not all day on Sunday, but I believe that I averaged 16 hours a day during that period.

Q. During the year '43? A. Yes.

The Court: Mr. Milliken, I will break in at this point for the benefit of one or two other matters.

(Short recess taken.)

The Court: Proceed.

Mr. Milliken: That completes the direct examination, Your Honor. [220]

Cross-Examination

By Mr. Crouter:

Q. Mr. Harmon, will you please tell the court your age at the present time? A. 43.

Q. Now, referring back to some of your testimony yesterday, Mr. Harmon, there is one of the companies I would like to ask you a little more

(Testimony of Walter S. Harmon.)

about. As I recall, about 1928 or perhaps a little after that, you for some period of time were associated in some capacity with this General Motors Corporation you mentioned?

A. General Motors Radio Corporation, yes, sir.

Q. Where was the office and headquarters of that company? A. Dayton, Ohio.

Q. You said that was a ten-million-dollar corporation? A. That is correct.

Q. When was it organized?

A. The Dayfan Electric Company was owned by Charles F. Kettering, who was vice-president in charge of research of the General Motors Corporation, and they decided to—the General Motors Corporation decided to engage in the manufacture of automotive radio receivers, and at that time were unable to obtain an R.C.A. license. As a result they acquired from Mr. Kettering the Dayfan Electric Company and then later a rather large corporate set-up was made in which R.C.A. also participated.

Q. That was before you went with the Zenith Radio Corporation? A. Yes.

Q. Zenith Radio was not affiliated in any sense with the General Motors, was it? A. Oh, no.

Q. Then with the General Motors Radio Corporation that you mentioned, about how long were you there with that company?

A. Well, when I think of that of course I think of Dayfan and General Motors because it was—it was combined. That was from 1928 to early 1932.

Q. And as I recall you testified that you received from \$60 to \$65 a week from that company?

(Testimony of Walter S. Harmon.)

A. I don't think I did. I didn't recall the amount of the salary. I was to find that later.

Q. What did you receive as best you recall?

A. When I originally started with Dayfan Electric Company, I started at \$35 a week, to the best of my knowledge that went up to \$55 a week.

Q. Yes, I believe the figure I mentioned is what you stated with respect to Zenith?

A. Zenith, I think that is right.

Q. Well, just exactly what was your position or what [222] were your duties when you were with this General Motors Radio Corporation? You were a way down the line, were you not, in the organization?

A. I think I explained that I held various positions. That is, in small groups. It was a rather finely integrated organization. I had a group one time that was known as the radio frequency group. In other words, we handled the development and design of anything relating to the radio frequency portion of the receiver. Later I headed the advance development group, which could be classified somewhat as research. In other words, we would take a project up to a certain point, and then turn it over to a design group. Later I headed up the entire household receiver section, in which case I reported to the director of engineering. I was directly responsible for design and engineering of all household receivers.

Q. Were you ever concerned with any of the corporations you have mentioned prior to the Mission Bell Corporation, with the mere production

(Testimony of Walter S. Harmon.)

angle of the business as distinguished from research and development on new designs, for instance?

A. Well, I think any engineer is concerned with production.

Q. I mean primarily. What I mean, were you ever in a production department which merely had as its chief objective the job of getting materials and stepping up and putting out production, so you were engaged chiefly on that rather than [223] what might be termed scientific development?

A. Well, with companies such as Distanttone Radio, that I mentioned back in the 1927 period, that was a rather small company and naturally there is not engineering work to keep a man busy all the time. So a receiver was designed and from then on I would follow production.

Q. Then you were not engaged during all of that period exclusively on scientific research and development of radio receivers and related instruments, were you? A. No, I wouldn't say so.

Q. Were there any other companies where you did get over into the production part of the business and we will say 50 per cent or more of your time was really occupied with manufacturing and producing and getting sales volume? A. No.

Q. Now, after the time that you went with Mitchell-Hughes, had the \$75 a week which I believe you testified you received from Emerson Radio Corporation been your top weekly compensation? Is that correct from your testimony?

A. Will you state that again?

(Testimony of Walter S. Harmon.)

Q. I mean the highest figure you received for services?

A. I don't recall how high my fixed figures ran at Mission Bell Company.

Q. Well, this is all before you went to Mission Bell, was it not. This is up to 1936? [224]

A. No, Mitchell-Hughes followed Mission Bell. I was with Mission Bell. I am not sure that I covered that in my testimony yesterday.

Mr. Milliken: Yes, you did.

Q. (By Mr. Crouter): Well, let's hear it again.

The Witness: I was with Mission Bell and then with Mitchell-Hughes, then Mr. Hoffman, Mr. Davidge and Mr. Douglas purchased the Mission Bell Company and I went back into the Mission Bell picture.

Q. (By Mr. Crouter): Yes, but Mr. Harmon, I am talking about the period entirely prior to that, before you first went to Mission Bell. As I understand your testimony yesterday, you were with Mission Bell first about 1936 or early in 1937?

A. That is correct.

Q. Prior to that time, what was the most compensation you had received for week or month or year, out of your engineering services with any one company?

A. I think at Emerson was the tops.

Q. \$75 a week? A. Right.

Q. Was that on a straight salary basis or was some of that a bonus or commission?

A. Well, I am sure it would be considered a straight [225] salary. I mean there were such things

(Testimony of Walter S. Harmon.)

as a Christmas bonus allowed and so forth, but that was rather small.

Q. Something relatively minor at Christmas?

A. That is correct.

Q. A \$100 bonus or something of that sort?

A. Yes.

Q. Would that also be true with respect to all of the companies that you worked for prior to working for Emerson? A. Yes, sir.

Q. Those are mostly straight salaries?

A. Yes, sir.

Q. No commission or bonus in any of those?

A. I don't recall any, no sir.

Q. Now, let's take from 1936 down. When you first went with Mission Bell about 1936 or early in 1937, what was the financial arrangement with respect to your compensation?

A. Well, \$50 a week and 10 cents on each receiver producer.

Q. And you were with the Mission Bell Radio Manufacturing Company for a period of about three years, that is between 1937 and 1939?

A. I believe it was closer to four.

Q. What are the definite dates there, if you recall them?

A. As I recall I went with Mission Bell in July of 1936 [226] and I am not sure of the exact date when I left in 1940, but I believe it was June.

Q. And during that period what was your position with the Mission Bell Manufacturing Company?

(Testimony of Walter S. Harmon.)

A. I was responsible for all engineering and design.

Q. And was that company chiefly engaged during that period as the assembly of what may be termed home receiving sets?

A. Home, and also auto radios.

Q. And auto radios? A. Yes.

Q. Did you have table models as well as the larger console models?

A. Table models, and consoles, yes, sir. I may point out then that our major business was contract manufacturing for Sears Roebuck, Hobbs Battery, I think we did some for Firestone and a little for Goodyear.

Q. Was there any appreciable change in your compensation during that period?

A. Well, it was varying up and down. I mean I would get the 10 cents per receiver.

Q. I mean, did the same scale continue through that period? A. Yes.

Q. \$50 per week and 10 cents per set? [227]

A. That is right.

Q. And the business really declined, did it not, so that your 10 cents per receiver was less in 1940.

A. Well, that is why I left in 1940, yes.

Q. How many senior and junior engineers did you have under your direction during that period when you were with Mission Bell?

A. Well, normally we carried one assistant.

Q. One assistant, and during the period from 1937 to 1940, about how many were the total employees of Mission Bell, the average number?

(Testimony of Walter S. Harmon.)

A. I think it varied up and down. I believe it would average, oh, I would say, probably 35.

Q. Who was the most active or senior officer of the corporation during that period, which of course was before Mr. Hoffman got into it?

A. There was always a little argument about that. Mr. Fleming was presumably president and Mr. Schmieter was vice-president, but that was the trouble. I think they both held equal shares of stock in the corporation or the company.

Q. Then, as I recall your testimony, you went with Mitchell-Hughes Company. Would that be about June, 1940, you went immediately from Mission Bell over to Mitchell-Hughes?

A. I didn't go immediately. I think there was a month or two lapse there. [228]

Q. During the summer of 1940 then?

A. Yes.

Q. Then did you state the exact amount of basic compensation there, or did you have any from Mitchell-Hughes?

A. I believe I stated in testimony that I went there during the early stages on a consulting basis, and then later that was changed to \$100 a week.

Q. How long did the \$100 a week continue, Mr. Harmon?

A. Well, I think it was all the period I was there.

Q. Do you remember about when Mr. Hirsch died?

A. Well, it would have been some time early, in 1941.

(Testimony of Walter S. Harmon.)

Q. How long did you continue in a consulting capacity, or in active duty with the Mitchell-Hughes Company?

A. I was on active duty there until, as I recall, December of 1941.

Q. Then that was practically up to the period when you became associated with the Mission Bell Radio Manufacturing Company?

A. That is correct.

Q. Did you have any bonus or commission—I will withdraw that. You have testified to the 50 per cent arrangement of the net profits, as I recall your testimony, there was some difference of opinion, and you never really received the 50 per cent.

A. Nothing was ever realized from that, no, sir.

Q. Then the \$100 a week is all you actually received?

A. That is correct.

Q. Did you decide to leave the Mitchell-Hughes Company before Mr. Hirsch died?

A. Oh, no.

Q. His death really caused the——

A. Well, I operated the company for the estate for several months after Mr. Hirsch's death.

Q. Was your disagreement regarding the 50 per cent with Mr. Hirsch or with the executors or the people handling the estate?

A. Oh, no, it was involved after Mr. Hirsch died because I felt in my own mind it was going to be a matter of liquidation eventually.

Q. I believe you were instrumental to some extent in acquainting Mr. Hoffman with the situation which existed in the Mitchell-Hughes Company at that time and apprised him of the facts so that as

(Testimony of Walter S. Harmon.)

testified yesterday it later developed that the entire plant inventory and so forth of Mitchell-Hughes then was acquired by Mission Bell?

A. Yes, I mentioned it to Mr. Hoffman.

Q. Can you give us any more detail as to the amount of the consideration for the purchase of Mitchell-Hughes Company assets and equipment?

A. I have no way of knowing that figure, sir. [230]

Q. You had nothing to do with it officially?

A. No. You see, I had already left Mitchell-Hughes.

Q. When did you first become acquainted with Messrs. Davidge and Douglas who were of course in the Mission Bell and the Hoffman Corporation?

A. Well, I had met them while I was still at Mitchell-Hughes. As I recall, Mr. Davidge and Mr. Douglas visited our display room one day. I don't remember the exact time.

Q. Visited at Mitchell-Hughes?

A. Yes, sir.

Q. Mr. Harmon, I would like to ask you about two or three little exhibits here, just to clarify a matter or two, while we have a copy of the stipulation here. Just turn to that if you will and look at Exhibit 15. Mr. Harmon, in your Exhibit 15 you observe this is a letter of March 10, 1942. This is from the Mission Bell Radio Manufacturing Company through Mr. H. L. Hoffman, as president, to you, and please tell us whether that is the first agreement of any kind you had with that Corpora-

(Testimony of Walter S. Harmon.)

tion regarding your employment by the Corporation and the terms of the employment.

A. As I recall this, it was a verbal agreement.

Q. Now, please examine the second paragraph and the reference there to the one per cent on gross volume of business done by the company after excise tax and other applicable taxes are deducted. At that time in March, 1942, the Mission [231] Bell Radio was still engaged in the production of radio sets and so forth for domestic purposes, was it not?

A. Yes, sir.

Q. At that time did you have any knowledge whatever of any eminent governmental restrictions of the production of radios for civilians?

A. Well, I don't recall—I certainly did not at the time the agreement was made.

Q. The war insofar as the United States of America was concerned of course had broken out, but even at that time people in the business I suppose were contemplating going ahead insofar as they could, was that the situation? A. Yes, sir.

Q. And you still contemplated continuation of the production and selling of radio receiving sets, chiefly in the domestic market?

A. Yes, and there was also some consideration being given to military equipment.

The Court: Your question, Mr. Crouter, by the words "at that time," which did you mean, March 10, the date of the letter or the time when the oral agreement was made?

Mr. Crouter: I meant the date of March 10, 1942.

(Testimony of Walter S. Harmon.)

Q. (By Mr. Crouter): Did you so understand the question? If not, tell us what your understanding was on that date. [232]

A. Yes, I—I think I stated that I don't recall what I might have been thinking in March. I do know at the time the verbal agreement was made that was just a compromise. I thought we were going to build radios.

Q. Well, the reference there to excise tax referred to the federal excise tax upon certain parts of a radio, did it not? A. Yes, sir.

Q. And that is what is referred to there?

A. Yes.

Q. Now please turn forward in your exhibits to Exhibit 13. You see that also is in evidence, and that is a copy of the minutes. It is dated May 14, 1942. Now between these two dates you learned, did you not, that effective about April 22, 1942, there was a governmental restriction placed upon the manufacture and sale of radios on the domestic market, or particularly I will limit that to manufacture, I believe.

A. I would presume so, yes.

Q. Well, can you tell the court now whether from your own knowledge, that is about the date, April 22? A. Oh, yes, April, yes.

Q. These minutes here shown by Exhibit 13, dated May 14, 1942, you will notice by the first paragraph after the meeting is called to order referred to the fact that a three hundred thousand dollar order was entered into with the Bendix [233] Avia-

(Testimony of Walter S. Harmon.)

tion, and that also refers to certain requirements of the Signal Corps. I suppose that related to the same order, did it not? Was that a Signal Corps order that Bendix was handling?

A. It was probably, I think it was the aircraft division, and I think it was probably for the Signal Corps, the U. S. Signal Corps.

Q. You observe in the paragraph below that your letter of March 10 with respect to employment is incorporated as approved in the minutes here of the Board of Directors? A. Yes, sir.

Q. So at that time you and the corporation officers really knew that there was some military business in prospect, didn't you?

A. In May of 1942, yes.

Q. Yes. Now, can you tell us how far back you and we will say Mr. Hoffman started taking any affirmative action to secure any military orders as sub-contracts, or anything of that character? In other words, when did that first start?

A. Well, may I refer back to the date of the contract here on this other?

Q. Surely. I believe that is shown here by exhibits there.

A. This would indicate it would be back around February. [234]

Q. I don't know whether these will help you, but here are Exhibits 3 and 4 which summarize some of the contracts. Please examine those documents or anything else that you have, if you have anything to refresh your recollection as to the definite date, and tell us what the date is.

(Testimony of Walter S. Harmon.)

A. As I say, the contract was dated February 10th, which would indicate the action was taken the very early part of February. That is on the variable condenser.

Q. How large a contract was that? Just tell us briefly what kind of a contract that was and how large.

A. Well, the dollar value was \$36,455.56.

Q. With what company, Bendix?

A. Bendix.

Q. Then I suppose it was contemplated even as of March 10, 1942, the Mission Bell Radio Manufacturing Company would possibly be in position to secure additional sub-contracts on various government orders, is that right?

A. Well, at least we had one order, yes. We were probably hoping.

Q. As I recall your testimony generally, you have testified about various things which were worked upon by you and other engineers in the taxpayer corporation, and certain developments and such matters in connection with all of those matters. Did you yourself go to any other laboratory or any other place in connection with your duties and confer with [235] other government officials or other engineers for other corporations?

A. I did no work for any other corporation, if that is what you mean.

Q. Well, I didn't mean work. Were you ever visiting and conferring with other engineers in the radio development business?

(Testimony of Walter S. Harmon.)

A. Yes, sir, I visited the Aircraft Radio Laboratory at Wright Field, Dayton, Ohio, many times, the U. S. Signal Corps Laboratories at Fort Monmouth, New Jersey, the Naval Research Laboratory at—well, right outside of Washington.

Q. And I suppose you went out to the California Institute of Technology, commonly known as Cal-Tech, in Pasadena, California?

A. Yes, sir.

Q. Made many trips up there, I suppose?

A. Yes, sir.

Q. And you, because of your position in the taxpayer corporation and on sub-contracts, also had what might be termed the entree to a good many things along that line, which the ordinary person did not have? Is that right? I mean with respect to radio development, particularly along the lines on which you were working, is that right?

A. Yes, I would say so.

Q. Did you ever go to other places, such as the U. S. [236] Bureau of Standards in Washington, D. C.?

A. No, sir. I have never been to the U. S. Bureau of Standards.

Q. Any offices in Washington, D. C., with respect to radio research and development?

A. Yes, the U. S. Navy Department Bureau of Ships, probably the Ordnance Department.

Q. Any other place you think of?

A. Well, the Pentagon Building.

Q. That was the War Department there across the river?

A. That is right.

(Testimony of Walter S. Harmon.)

Q. I notice among your contracts and memorandum contracts a good many references to Signal Corps orders. Was that chiefly for the Army, particularly in 1943?

A. Yes, Signal Corps, yes, that would be the Army.

Q. And did you do any work as a prime contractor for the Navy Department, for instance?

A. In the latter part of 1943 that LM frequency meter was a Navy order.

Q. Were there other engineers, perhaps some of your senior and junior engineers in your taxpayer corporation who also spent some time at least in some of these other research laboratories during 1942 and 1943?

A. Yes.

Q. And about how many of them at different times? Just [237] give us a general idea on that.

A. Well, on the Navy Department frequency meter order, on one occasion I took two engineers with me east.

Q. About how much time did they spend there?

A. As I recall, we were east about a week.

Q. And you had two or three engineers stationed at Cal-Tech for some time, too, did you not?

A. They were not stationed at Cal-Tech, no, but they were coordinating between the two.

Q. That is what I mean, doing development work there?

A. Oh, yes.

Q. How much time did they spend there separate and apart from your own plant?

A. Well, I don't think they spent very much time at Cal-Tech's laboratories. Quite a lot of time

(Testimony of Walter S. Harmon.)

was spent in field tests, at which in many instances Cal-Tech men went along as observers.

Q. Did any of your engineers ever go?

The Court: That is mighty indefinite. I am going to wonder how much time that means when I come to read that. It is pretty indefinite. Can you find out more definitely?

Q. (By Mr. Crouter): Can you make it more specific, tell us how many men or how many days of their time or something tangible?

A. At California Institute of Technology? [238]

Q. Yes.

A. Oh, as an estimate I would say three men, fifteen days.

Q. During the two years? A. Yes.

Q. Did they spend that much time at any other laboratory, any one engineer? A. No.

The Court: That is fifteen days each?

The Witness: Yes, sir.

Q. (By Mr. Crouter): Now, in connection with the development work that you testified to that was at your corporation's plant in 1942 and 1943 with respect to all those various matters, it is true, is it not, Mr. Harmon, that you and other engineers in the taxpayer corporation's plant relied upon and conferred and agreed with other radio engineers in the government service and in the other private employment with respect to their matters in which you had sub-contracts and on which you were working, is that true? A. Oh, I don't think so.

(Testimony of Walter S. Harmon.)

Q. Would you say that that did not happen as to any of those matters that you have testified to that you developed, previously?

A. Normally our contract with other engineers was because [239] we were trying to interpret their requirements. We were responsible for the design.

Q. Well, take the antenna kites, for instances, that was done through Bendix, was it not?

A. Yes.

Q. Did Bendix sub-contract some of these orders to other manufacturers for that kite?

A. I think at a later date, I think as I recall, the James Head Company manufactured kites, but I don't think they manufactured them for Bendix. Another source of supply was set up in the east for the so-called Gibson Girl transmitter, manufactured by Kingston. It was felt that another source should be set up.

Q. What was the purpose of having engineers in the employ of your company confer with scientists of the California Institute of Technology and some of these other places?

A. Well, as I recall, they were handling the pure research for us on this project.

Q. What project?

A. On the Fire Error Indicator.

Q. Is that the only thing that was the subject of conferences and communications with other laboratories? Is that your testimony?

A. Not the Fire Error Indicator would not involve the other laboratories, no. [240]

(Testimony of Walter S. Harmon.)

Q. That was not new with your company, by the way, was it? Isn't that a matter that the military had been working on for a long time?

A. The fire error indicator?

Q. Yes.

A. It had been worked on for quite a long time.

Q. To what extent had it been developed before you got into it at all, as you testified here?

A. Our contract was to take this piece of equipment and place it into production. This is an equipment which was merely prototype equipment that had been produced up to now.

Q. And it had been completed before that and some models produced? A. Sure.

Q. And you were merely given an order for reproduction of a thing of that sort?

A. No, we were not to produce it in the form that they had produced it. We had to produce a piece of gear that would give consistent performance after being released, after targets had been released on this terrific acceleration involved, and the prototype equipment was merely what you might call laboratory models, experimental models.

Q. Was your company the only one that produced those fire indicators? [241]

A. As I recall, it was, yes, sir.

Q. Well, a great many of those things that you have testified about, Mr. Harmon, were really regarded somewhat as smaller shop orders, were they not, and handled in that manner, because they were subcontracted or bid from prime contractors?

(Testimony of Walter S. Harmon.)

A. If you mean the design was complete when we received it, no, there wasn't any in that condition.

Q. Isn't it true that for several of those you were given specifications and so on to tell you exactly what was wanted?

A. Not exactly. The specifications you received were as to the performance desired.

Q. Do you have any of your bids or any of the contracts here now that you had with Bendix or Kingston? A. That I don't know, sir.

Q. You didn't bring them to court, did you? Have you brought any of those around as samples here? A. I didn't personally.

Q. Did you have to bid on most of those sub-contracts with the Bendix and with Kingston in 1942 and 1943? A. Yes, sir.

Q. Was there bidding by some of your competitors and other people who wanted to get that business? A. Yes, sir. [242]

Q. And you had to know then in advance generally what they wanted and about what it would cost to produce it, did you not?

A. That is right, sir. Usually the bids were accompanied with a proposal showing how we planned on doing it.

Q. And then you would have to make decision when you were trying to get business about what was wanted and what you could produce, isn't that true? A. Yes.

(Testimony of Walter S. Harmon.)

Q. Now, with respect to the two years 1942 and 1943, most of your development was done in which year? A. Probably 1943.

Q. The things that you have testified to now were mostly in 1943?

A. Well, of course, we developed the variable condenser and the kite in 1942.

Q. How many of these other things?

A. As I recall, the A-62 phantom antenna was developed in 1942 and the A-58 phantom antenna.

Q. Would it be correct to say that most of the things you have talked about here were developed in 1942?

A. Not as far as the dollar volume and the engineering, amount of engineering effort. Probably there was more engineering effort expended in 1943 than in 1942.

Q. What were the things which produced the greatest [243] dollar volume of all your contracts?

A. The LM frequency meter.

Q. When was that developed?

A. It was in 1943.

Q. Now, I take it your testimony with respect to the 16 hours a day referred to both years?

A. Yes.

Q. That was——

A. I refer to the war years.

Q. And that was six days a week, and sometimes part time on Sunday? A. Yes, sir.

Q. You heard Mr. Hoffman's testimony yesterday about working several nights in a row as well as days, didn't you? A. I did.

(Testimony of Walter S. Harmon.)

Q. Were you in that group?

A. I was in that group, yes sir. I did not work that many nights.

Q. Can you tell me what year that was in?

A. It was in 1942.

Q. And what portion of 1942?

A. Must have been February.

Q. That was early in the game, when you were first getting subcontracts? A. Yes, sir. [244]

Q. Mr. Harmon, I want to ask you about the year 1942 and your compensation in that year. You say the agreement and the minutes that we have talked about here showed the basis for it. Now, please tell us the total amount of your compensation **from all sources in 1942**, and in that connection I show you what appears to be your 1942 income tax return.

A. This would be indicated as \$6,680.32.

Q. Is that the total amount of gross income?

A. Oh, no. Wait a minute. No, I am sorry. Up here. This is \$7,244.18.

Q. Now, let's look at the schedule. I want to know whether this is all from Mission Bell. Well, the source is not indicated. Would you say that is all from Mission Bell or partly from some other source?

A. 1942, it would be all from Mission Bell.

Q. And you were giving exclusive time to that company, so I take it then you had no income from any other source? A. That is correct.

(Testimony of Walter S. Harmon.)

Q. And that is from what date in 1942? Did you work there at all prior to March 10th, the date of your agreement?

A. As I recall, I started in January.

Q. When you first went there in January, what agreement, if any, did you have as to your compensation?

A. Exactly the same as was later written in this. I don't recall the date of it. [245]

Q. The agreement of March 10, 1942?

A. Yes, sir.

Q. \$75.00 per week plus 1 per cent on gross volume. A. Yes, sir.

Q. I see. Did either Mr. Davidge or Mr. Douglas do any work in connection with the operation of the corporation in 1942 or 1943?

A. I believe Mr. Douglas was with us for a short period of time.

Q. In what capacity?

A. I really don't know.

Q. Did you see him around there doing any work in any particular department?

A. I remember seeing him count rivets.

Q. Do you know whether he had any compensation arrangement with the corporation for what he did? A. No, sir, I do not.

Q. In general, then, do I understand that they did not assist you or do anything at all in connection with engineering development or production, is that right?

A. Speaking now of Mr. Davidge and Mr. Douglas?

(Testimony of Walter S. Harmon.)

Q. Yes.

A. I don't think they did, no.

Q. Did any of your engineers ever go to the R.C.A. headquarters at New York in connection with any of this [246] engineering development?

A. No, sir.

Q. How many of these various seven or more particular things that you have testified to that you developed and worked upon there, such as the variable condenser and kite and so forth, do you yourself claim credit for, or do you claim credit for all of them?

A. I don't claim full credit for any engineering project. I directed the effort.

Q. Did you yourself develop the main idea which your company carried and and perfected which went into the manufacture of any of those things?

A. Not necessarily, no, sir.

Q. It was mostly done, then, insofar as your corporation was concerned, by junior engineers in your organization but over whom you had supervisory control and direction?

A. Yes, sir.

Q. That is the picture.

Referring to testimony about certain tests that were made, I believe, at Camp Irwin, where was Camp Irwin located?

A. Just a little beyond Barstow.

Q. Out in the desert area east of Los Angeles.

A. Yes, sir.

Q. What was the O.S.R.D. that you referred to, [247] for the record?

(Testimony of Walter S. Harmon.)

A. That is the Office of Scientific Research and Development.

Q. That was one of the offices that you worked in close collaboration with during the war period?

A. On the fire error indicator, yes, sir.

Q. I suppose the military branches, particularly the Army and Navy, had considerable number of representatives in that organization.

A. No, I don't think they had many representatives in that. As I recall, the O.S.R.D. was a division of the N.D.R.C., National Defense Research Council.

Q. What officers or individuals were most prominent in arranging and conducting these tests you speak of, in the O.S.R.D.?

A. There would usually be one observer from O.S.R.D.

Q. Was that an organization which headed up in Washington, or where? A. Yes.

Q. That is Washington, D. C.?

A. Yes, sir.

Q. They had military observers there certainly, did they not?

A. Very few on the tests that we would conduct.

Q. How many men would your corporation have out on [248] such tests?

A. Oh, sometimes three, possibly four.

Q. Who primarily arranged and coordinated such tests?

A. California Institute of Technology did most of that.

(Testimony of Walter S. Harmon.)

Q. Did they have a number of scientists and radio electricians there, too?

A. I would say their crew would be about equal to ours.

Q. Then it was not solely under your auspices or jurisdiction at all? That is correct, isn't it?

A. The tests, no, sir, that is right.

Mr. Crouter: I believe that is all. Thank you.

Redirect Examination

By Mr. Milliken:

Q. Mr. Harmon, would you please tell the Court what part, if any, Mr. Hoffman played in matters of research or engineering or matters relating to your department?

A. Well, generally all projects were handled by a coordinating group which Mr. Hoffman headed up. In the group would be the members of the engineering department involved in the particular project, also the procurement man. Mr. Hoffman naturally directed our activity. In any of these group discussions of problems involved, a great many people contributed to things that even might be of an engineering nature.

Q. Did Mr. Hoffman discuss with you during 1942 and [249] 1943 the feasibility or the non-feasibility of making bids for particular types of work for the Army or Navy?

Mr. Crouter: If your Honor please, I object on the ground it is leading.

Mr. Milliken: Your Honor, if I may reframe that, you would have a question without an objection.

(Testimony of Walter S. Harmon.)

The Court: The objection is overruled.

The Witness: I would say he did.

Mr. Milliken: That is all.

Mr. Crouter: No questions.

The Court: Let me ask this witness, or I might only direct counsel's attention to it. As much as anything I want to know what it means, and that is in connection with some of this testimony. I notice that this Exhibit 15 dated March 10, indicates that at that time in confirmation of some previous conversation Mr. Harmon is to get \$75.00 a week salary and 1 per cent of the gross volume of the business. Then I notice that later in these minutes of May 14, 1942, because he has now terminated his connection with Peerless Electrical Company, which, incidentally, makes me wonder whether he is correct in his statement that all of his salary in 1942 was from the Petitioner company.

The Witness: That is Mr. Hoffman.

Mr. Milliken: I don't think that is—this witness was never an employee of the Peerless. That is Mr. Hoffman. [250]

The Court: Oh, yes, I was altogether confused. I thought it was the same man. If it had been, there would have been confusion there.

Anything further from this witness?

Mr. Crouter: Just one question.

Recross Examination

By Mr. Crouter:

Q. Would you look at Exhibit 15 again there, Mr. Harmon? I asked you previously about this

(Testimony of Walter S. Harmon.)

and I want you to look again at the first part of the second paragraph. You see the first paragraph says they confirm our conversation and verbal agreement in January, this is to confirm our arrangement at that time, then refers to \$75.00 per week, and then Paragraph 2 "in addition to the above, we will pay you an override of 1 per cent" and then 1 per cent in parenthesis "on the gross volume of business done by the company after excise tax and other applicable taxes are deducted."

A. It should have been all one paragraph.

Q. At that time, though, doesn't that indicate, or does that refresh your recollection as to whether the 1 per cent was really in the picture as of March 10, 1942?

A. Oh, no, no. As I say, that really should have been written as one paragraph there. The 1 per cent was always in from the first. I would say that is wrong there. I think it should have been combined in the first paragraph, instead [251] of making a new paragraph of it.

Q. But this was the first writing between you and the company indicating this? A. Yes, sir.

Mr. Crouter: I see. That is all. Thank you.

The Court: We will be recessed for 10 minutes.

(Short recess taken.)

(Witness excused.)

Whereupon,

WALTER D. DOUGLAS

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Tell us your name, Mr. Witness.

The Witness: Walter D. Douglas.

Direct Examination

By Mr. Milliken:

Q. Where do you reside, Mr. Douglas.

A. At 501 South Hudson Avenue, Los Angeles.

Q. How long have you lived in Los Angeles?

A. Since 1920.

Q. Prior to 1941, or in the year 1941, what business were you engaged in?

A. Well, I was in 1941, the early part I was in Edgin & Company and Standard Utilities. [252]

Q. What business are they engaged in?

A. Edgin & Company was a wholesale retail plant outfit that held the warranted agency for Motorola and Philco automobile radios.

Q. What was the other company?

A. Standard Utilities was a distributor with the Farnsworth Radio, Acorn Stoves, and I think there were one or two other smaller lines.

Q. What was that— a proprietorship on your part, or what were each of those?

A. Standard Utilities was a partnership in which I was a partner. Edgin & Company was a corporation of which I was a stockholder.

Q. Who were the other stockholders?

(Testimony of Walter D. Douglas.)

A. In Edgin & Company Mr. Davidge and myself, I think, held the capital stock, and Mr. Edgin held a preference stock.

Q. Is the Mr. Davidge to which you have referred the Davidge that was associated with you and Mr. Hoffman in this Mission Bell Radio deal?

A. Yes, he is.

Q. Had you been in any other line of business in 1941 or prior thereto?

A. Well, prior to I was in the investment business from 1932 to 1940.

Q. What was the nature of that business? [253]

A. Well, I had went to work for White & Company as statistician in 1932, stayed there until about February of 1933, and went over and assisted in the formation of Nelson Douglas & Company, which was an investment house which was formed at that time, and stayed with them until 1940, when I left and went in with Edgin & Company.

Q. Were you only an employee or did you have an interest in Nelson Douglas & Company?

A. I had an interest. It was a corporation and I was a stockholder.

Q. And what was the business generally of Nelson Douglas & Company, the business in which they engaged?

A. Well, they had a combination investment counsellor and general securities house. It was not a wire house, not a straight brokerage house.

Q. What were your duties with Nelson Douglas & Company?

(Testimony of Walter D. Douglas.)

A. Well, for the first part, the first few years I was in charge of the statistical department, and later moved on as duties connected with the cashiering end. I was treasurer of the company and was to supervise the general bookkeeping and cashing.

Q. At Nelson Douglas & Company were your efforts directed to the revival and restitution of businesses that might have been in financial difficulties, or was their business entirely one of securities? [254]

A. Well, it was entirely one of securities. However, in 1932 a great many securities were in the condition you speak of, and in that respect we were forced to at least explore the condition of companies that were in rather bad shape.

Q. You mean, for example, such as bondholders' protective committees and things of that kind?

A. That is correct.

Q. Incident to businesses that were in financial difficulties.

A. That is correct.

Q. When, for the first time, if you did have any knowledge with respect to the business carried on by the Mission Bell Radio Company, were you familiar with that prior to 1941?

A. Well, familiar to the extent I knew they were in the radio receiver manufacturing business. I had seen a certain number of their sets. I think I had one at one time, and as far as being connected with or knowing any of the personnel or having actually been in their plant, I hadn't.

(Testimony of Walter D. Douglas.)

Q. During the year 1941 was the Mission Bell setup and its difficulties, if it had any, presented to you for consideration?

A. Yes, I think—well, it was presented once rather generally, and at that time nothing was done. There was no [255] particular initiation of any effort. Then late in 1941 the subject came up again and I reviewed it much more thoroughly at that time, and as the result made a connection with Mr. Hoffman.

Q. Are you related to Mr. Hoffman?

A. No, I am not.

Q. Any of your family related to him?

A. No, sir.

Q. Had you known Mr. Hoffman prior to the year 1941? A. No, sir.

Q. Will you please tell the Court the conversation and discussions that ensued between you and Mr. Hoffman when he came to you with a proposition concerning Mission Bell?

A. Well, the same—the core of the discussion was that here was a company which had been in business for some period of years; that at one time they had enjoyed a rather good reputation, done a considerable volume of business, and there were apparent confusion in management and inability to market their product or make the right contacts; they had gone down hill and were in a position where—well, there wasn't much ahead for them as they existed under the present management, but that it was a corporation which had the entity and some of the physical necessities, had various potential assets which might be developed, if taken over and operated in an efficient manner. [256]

(Testimony of Walter D. Douglas.)

Q. Who was present at these discussions which you have just related?

A. Well, I think primarily there were Mr. Hoffman, Mr. Davidge and myself. I think Mr. Edgin sat in on possibly one of them, but he was not too interested in it and dropped out, and I think the bulk of the conversations were the three of us.

Q. Could you designate as nearly as you can the time of those early discussions which you had with Mr. Hoffman, at which you were present and Mr. Davidge was present?

A. Well, as I recall, they were somewhere around—started possibly the latter part of October or November of 1941, to the best of my memory. It was the latter part of the year.

Q. Did you and Mr. Davidge and Mr. Hoffman come to some agreement with respect to your interest in the matter, or did you abandon this matter?

A. No, we finally came to an agreement.

Q. Will you please state to the Court what the agreement was that you and Mr. Davidge had with Mr. Hoffman, all three of you being present, as I understand it?

A. Well, it was a rather involved agreement, because first of all we had only an agreement between the three of us as to how the matter would be handled if Mr. Hoffman could make an arrangement to purchase the Mission Bell Corporation. We agreed on the basis of the stock. When I say we agreed, [257] this, of course, was partially the result of Mr. Walker, who was Mr. Davidge's attor-

(Testimony of Walter D. Douglas.)

ney, as to the final wording and everything of the agreement, but it concerned the disposition of the stock or various stock interests, the amount of money that we would put in, our position in the company if it were formed. That is the general outline of that agreement, all, of course, being subject to Mr. Hoffman's purchasing control or the entire control of Mission Bell.

Q. Well, there are in evidence in this case, Mr. Douglas, agreements that Hoffman executed for the purchase of Schmieter's stock and Warner's stock and of Fleming's stock, and there is also an agreement dated December 9, 1941, which is in evidence, between you, Mr. Hoffman and Mr. Davidge. Had you agreed orally prior to such dates as to the basis upon which you would go into the deal, assuming that Hoffman could purchase the stock?

A. Yes, that is correct. In other words, we came to an oral understanding and I think—yes, our agreements, as I recall, were all drawn up long before they were signed or accepted, and I say long before, days before, and on that basis all the agreements were agreed upon, even though the signing was chronologically different.

Q. I understand that those agreements were drafted by Mr. Walker, who was the attorney for Davidge.

A. That is correct. [258]

Q. What was the agreement with respect to the stock of Mission Bell, assuming that Hoffman could purchase the same?

A. Well, the agreement on the stock was that Mr. Hoffman was to have 50 per cent and Mr. Da-

(Testimony of Walter D. Douglas.)

vidge and myself each 25 per cent. You mean that portion of the agreement?

Q. Yes. In other words, you were to have 25 per cent of the stock, Davidge 25 per cent of the stock and Hoffman 25 per cent of the stock—Hoffman 50 per cent of the stock.

A. Hoffman, 50 per cent, that is correct.

Q. And you recite in your agreement on December 9, 1941, which is in evidence, that Hoffman was to acquire this stock and to hold it in trust for you and Davidge, with your respective interests.

A. That is correct.

Q. Isn't that correct?

A. The stock was purchased on a—I guess it was a monthly payment plan, and there was naturally always the possibility that the purchase would never be completed and the stock would never be issued to Hoffman, Davidge and myself. For that reason it was decided best to have Hoffman, who would make the original contract, hold it as trustee with our various interests set forth.

Q. In the agreement of December 9, 1941, it is also agreed that you and Davidge should be on the board of directors of this corporation after Hoffman had acquired the stock, is [259] that correct?

A. That is correct.

Q. Did you go on the board of directors?

A. Yes, sir.

Q. Did Davidge? A. He did.

Q. Take the years 1942 and 1943, were you and Davidge on the board of directors?

(Testimony of Walter D. Douglas.)

A. Well, in Mr. Davidge's case he was on until early in 1942, when he went into the service, at which time he appointed or nominated Mr. Paul Adams to serve for him during his absence.

Q. Mr. Paul Adams being—

A. An attorney. In my case I left in the summer of 1942 to go into service, and my wife, acting under a power of attorney, represented me on the board of directors during my absence.

Q. And how many were on the board of directors of the corporation during 1942 and 1943?

A. I think three were all.

Q. Mr. Douglas, I would like to ask you a personal question. Looking at yourself in 1941, how much were you worth? What was your net worth?

A. Oh, I would say three-quarters of a million.

Q. And do you know the net worth of Mr. Davidge? [260]

A. No. I would say that he was at least equally comparable to my own position.

Q. Well then, when you went into this deal in 1941 and had your arrangement with Mr. Hoffman, did you have any arrangement with respect to your financing of the company? What was you and what was Davidge to put into the company?

A. Well, originally as I recall the original amount was \$10,000.00, put in two thousand by Mr. Hoffman and four thousand apiece by Davidge and myself. I might say that we realized that if the operation went through that it would probably require more financing later, but that was, as I recall, was the initial amount which we invested.

(Testimony of Walter D. Douglas.)

Q. Did it require financing the latter part of the year 1942 and 1943 by yourself and Mr. Davidge? A. It did.

Q. And did you put in additional sums?

A. I did, sir.

Q. You loaned additional sums, did you, or how did you handle your contribution?

A. It was handled by loans to the company.

Q. Did you discuss with Mr. Hoffman, prior to the execution of these agreements on December 4, 1941, and December 9, 1941, the basis upon which he was to be employed by Mission Bell?

A. Yes, sir, we did. [261]

Q. Please state what discussions you had, and if you reached an agreement, what agreement you reached?

A. We talked about salaries, and the agreement was that at that time the company could not afford to pay an excessive salary to any of the executives; that in that condition we felt that an incentive type of arrangement, which would give Mr. Hoffman the desire and the incentive to create something out of this defunct company, or virtually defunct company, was the best method for all of us. It would give him an opportunity of building something and permitted us to share in whatever growth there was in the future. As the result we arrived at a nominal monthly salary, I cannot tell you exactly how much it was. It was relatively small, and a percentage of the sales.

Q. Do you remember what the percentage of the sales was to be?

(Testimony of Walter D. Douglas.)

A. Yes, sir, it was 3 per cent.

Q. 3 per cent of the sales. You say you were to invest four thousand, Mr. Davidge four thousand. Did you do that presently? I mean, did you do that in December, 1941, or January of 1942?

A. December, I am sure it was December of 1941.

Q. I think the evidence in this case shows that on December 4, 1941, there was a directors' meeting of the Mission Bell, and it shows that you and Mr. Davidge were [262] elected to the board of directors, together with Mr. Hoffman, and those were the three that composed the board of directors.

A. That is correct.

Q. And that was true during the years 1942 and 1943, save for the intervention of a nominee of yourself or the intervention of the nominee of Mr. Davidge?

A. That is correct.

Q. Did Mr. Hoffman discuss with you and Mr. Davidge the employment of Mr. Walter S. Harmon?

A. He did.

Q. Will you please state the discussion that ensued?

A. Well, first of all we had to find an engineer if we were going to do any business. Through checks made on Mr. Harmon he seemed to be a very capable man and one that we could do very well to employ. The question of employment and compensation was a little difficult, because there again we were not in a position to pay an excessively high salary, and we certainly had not too much to

(Testimony of Walter D. Douglas.)

attract a man of Mr. Harmon's capacity, unless there were some similar arrangement such as we had made with Mr. Hoffman, to give him the incentive to come and work and grow with the company, and as the result we agreed on a nominal monthly salary plus a similar percentage of the sales, I think it was 1 per cent of the sales.

Q. Did you and Mr. Davidge discuss this fully with Mr. Hoffman? [263] A. We did.

Q. Did you give Mr. Hoffman directions with respect to the employment of Mr. Harmon?

A. Yes.

Q. You approved, did you? A. Yes, sir.

Q. Or did you not? A. Definitely.

Q. You approved of his employment.

A. Certainly.

Q. Mr. Harmon has testified that he began work there in 1942, January. Does that conform to your recollection?

A. I think that is correct. It was shortly after the first of the year.

Q. 1942? A. '42, yes, sir.

Q. As an investor in this business, did you feel that the compensation arrangements with Hoffman and Harmon would be fair and would not unduly drain your capital investment in the company?

A. I did.

Q. In the agreement of December 9, 1941, which is in evidence, that being the agreement executed between you, Mr. Hoffman and Mr. Davidge, did you provide in any manner whereby you and Davidge

(Testimony of Walter D. Douglas.)

could exercise predominant control [264] with respect to this company, Mission Bell?

A. Well, we had a majority vote of the board of directors. We had, on the basis of stockholders, we had at least a block there, and it was agreed that inasmuch as we had put in the bulk of the money that if at any time during the course of this stock purchase contract that we could withdraw and stop at that point.

Q. And would Hoffman be likewise required to stop at that point, if you and Davidge so desired?

A. As I recall, he would, unless he found other capital to continue. I don't recall whether we was enjoined from continuing it or not. I know we had the right to stop as far as we were concerned and withdraw.

Q. Have you and to your knowledge has Mr. Davidge ever expressed any dissatisfaction with the compensation arrangements which you had with Hoffman and Harmon?

A. Well, I have never had any dissatisfaction, and Mr. Davidge has never spoken to me along that line at all, I mean, never indicated to me that he was dissatisfied with it.

Q. So throughout the year 1943 there was complete and harmonious satisfaction on your part and so far as you know on Davidge's part with respect to the compensation agreements with Hoffman and with Harmon. A. That is correct.

Q. Do you remember who approached you with respect to [265] interesting you, if possible, in the

(Testimony of Walter D. Douglas.)

Mission Bell deal, prior to the time Mr. Hoffman approached you?

A. No. As a matter of fact, I am not even sure, as I recall—we heard about it through Mr. Edgin, who said that somebody he knew in the business had been in, and it is possible that I was not there when they had their discussion, and found out entirely from Edgin, because I don't recall any one individual telling me the story, except hearing it through Davidge and Edgin.

Q. Well, did Mr. Edgin advise you what his reaction was concerning you going into the deal or Mr. Davidge, speaking now before you saw Hoffman? A. Yes, Mr. Edgin——

Mr. Crouter: If your Honor please, I object to this on the ground it is hearsay, irrelevant and immaterial.

The Court: You are asking him to state—read me the question.

(The question was read.)

The Court: Objection sustained.

Mr. Milliken: My purpose, your Honor, in asking that question, is to show that the Mission Bell had been discussed by other people, turned down and it was not until he saw Hoffman——

The Court: Of course, you are asking this man for some hearsay, are you not? [267]

The Court: Read the question again.

Mr. Milliken: I am asking if he was informed.

(The question was reread.)

(Testimony of Walter D. Douglas.)

The Court: What his reaction was would be a fact, as I see it, although it would come within the hearsay rule. Objection sustained.

Mr. Crouter: That is true even—is Mr. Edgin still alive?

Mr. Milliken: I don't know.

By Mr. Milliken:

Q. Is he alive?

A. No, sir, he is dead.

Q. Did Mr. Edgin advise you of any decision he had reached with respect to becoming interested in the Mission Bell deal, prior to the time you saw Mr. Hoffman?

Mr. Crouter: I object on the same ground, and particularly it is immaterial.

The Court: I don't think it is altogether material—I mean, altogether immaterial. That is not what I am thinking of, but as to whether or not it comes within the hearsay rule. You will have a chance to cross examine. I understand this man is dead, but this does not seem to be self-disserving testimony at all. Perhaps it couldn't be, pretty hard to say whether it was self-serving, but it certainly could not be called self-disserving. This particular question, however, [267] calls for a yes or no answer, and instead of sustaining the objection I think I will let him answer this question yes or no, although it leads nowhere really.

The Witness: May I have the question?

(The question was read.)

(Testimony of Walter D. Douglas.)

By Mr. Milliken:

Q. Just say yes or no. A. Yes.

Q. Will you state what he advised you?

A. He was against it.

Q. Did he state why he was against it?

A. Well, he—Mr. Edgin was a man who did not particularly like to go outside his own sphere of operations. I think that is—that was one reason; the other, he didn't feel that the company had any prospects.

Mr. Milliken: That is all, may it please the Court.

Cross Examination

By Mr. Crouter:

Q. I take it, Mr. Douglas, that Mr. Edgin was not particularly interested at all in any radio matter, is that right?

A. Well, he was very much interested in the sales of radios, because that was his business.

Q. Did he then have any interest, financial interest, in any radio manufacturing or assembling or producing company? [268]

A. No, he did not.

Q. Now, Exhibit 7 in this case, Mr. Douglas, is a copy of the agreement of December 9, 1941, between you and Mr. Davidge and Mr. Hoffman, and it indicates that you loaned to the company apparently—by that I mean the Mission Bell Radio Manufacturing Corporation—the sum of \$4000.00. I take it that you actually did that. A. Yes, sir.

Q. Was that done late in December, 1941?

(Testimony of Walter D. Douglas.)

A. As I recall, it was the middle or the latter part of December.

Q. Was that handled on the basis of a loan, or did you consider that that was an investment whereby if the venture turned out to be successful you would secure your 25 per cent of the stock of the corporation?

A. Well, it was entered into with the idea and hopes that it would be successful and that 25 per cent would accrue to me.

Q. That was more or less, in a practical sense that was the cost of that stock then which was later issued to you about the first of 1944, isn't that right?

A. I don't know whether you would tie that into the cost of the stock, because there were other moneys went in there. It was an investment in this general procurement program, stock procurement program. However, as I say we [269] anticipated further money would be advanced.

Q. Now, referring to your testimony about securing additional money for the corporation, particularly in 1942 and 1943, did you yourself personally loan to the corporation or advance to it for any purpose any sums of money that belonged to you?

A. Yes, sir.

Q. How much in 1942 or 1943?

A. Oh, I can't break it down by years. I would say in the aggregate it ran up to around \$40,000.00.

Q. Over what period?

A. I would say between December of 1941 and the end of 1943.

(Testimony of Walter D. Douglas.)

Q. And how was that actually treated with respect to any documents written at the time?

A. In the initial stages it was considered as a loan to officers.

Q. A loan to officers?

A. Pardon me. I am getting my—it was a loan from officers.

Q. Was there a note given, a promise to pay that back? Did you have such a note from the corporation?

A. There was some documentation. I have forgotten whether it took the actual form of a note or whether it was a letter that indicated the amount of the obligation and who [270] had advanced the money.

Q. You understood, of course, particularly after the corporation secured some subcontracts for government work, that it was undertaking some rather large manufacturing undertakings, didn't you?

A. Yes, sir.

Q. By the way, were you ever an active officer of this corporation? Did you spend any time at the offices of the company itself there?

A. In 1942 there were probably two or three months when I spent, oh, possibly half of my time there. From then on until I came back from service, no, I did not have a full time job there.

Q. During the time that you did spend there in 1942, Mr. Douglas, did you have any arrangement for compensation?

(Testimony of Walter D. Douglas.)

A. There was an arrangement made sometime in the spring of 1942. I can't tell you just when, but there was an arrangement for compensation.

Q. Did you receive compensation for services rendered there? A. Yes, sir.

Q. What amount and at what rate?

A. I think it was around \$300.00 a month, somewhere in that neighborhood.

Q. In just a little more detail, what did you do there [271] in the early part of 1942? Were you chiefly concerned with the financial operation of the company, or production? A. Financial.

Q. Almost entirely. A. Yes, sir.

Q. When you first made your advance of \$4,000.00 into the company in 1941, it was then contemplated that the company would merely proceed in the manufacture and assembly of radio receiving sets, was it not?

A. I would say that is generally—yes, sir.

Q. Isn't it also true that up to the time of December 9, 1941, which was two days after Pearl Harbor, of course, even at that date your entering into this venture was chiefly having in mind the idea of manufacturing and producing some kind of radio sets for the domestic market?

A. Basically, yes, sir.

Q. You had no ideas at that time or even, we will say, about the 1st of January, 1942, that the 1943 business would amount to anything like what it did amount to, isn't that a fact?

A. Well, I don't think that I ever speculated too much on any specific amounts. I had hopes that

(Testimony of Walter D. Douglas.)

the company would increase and produce a volume of business, but to what extent I hadn't tried to estimate.

Q. You had no ideas at that time that you would exceed [272] a million dollars in gross business, did you, in 1943?

A. No, I probably did not.

Q. Mr. Douglas, our stipulation here has an Exhibit 6, you have a copy of that there. That is the agreement of December 4, 1941, between Mr. Hoffman and Mr. Fleming, and I call your attention to pages 2-A and 2-B, which apparently have been inserted in that exhibit, and particularly to page 2-A. I call your attention to the first half of that page. I would like to have you read that, and then I want to ask you further questions about it.

The Court: What exhibit is that?

Mr. Crouter: That is Exhibit 6, if the Court please, Petitioner's Exhibit 6, page 2-A.

Q. (By Mr. Crouter): Now, after having read that, do you recall that it apparently referred to a situation whereby Mr. Fleming had apparently had a note for \$1,000.00? You will notice from the beginning of that paragraph he may have had another one for \$1,500.00 for an account for salary for services rendered, and do you recall whether there was discussion between you and Mr. Harmon and Mr. Davidge regarding the question of paying back Mr. Fleming and how long it might take to do that? That is what that refers to, is it not?

A. Yes.

Q. Paying it in installments? [273]

(Testimony of Walter D. Douglas.)

A. That is correct.

Q. I want to ask you particularly regarding the latter part of that paragraph near the center of the page, after the figure \$1,500.00, right near the center: "It being expressly agreed that for the purpose of determining whether or not such company is in a position to pay such dividends, the salaries paid to officers and/or employees of such company who during such year have been stockholders of such company, shall be taken to aggregate not more than \$12,000.00." Tell us what that figure shows and how that happened to be inserted in there?

A. Frankly, I don't know. I can't recall how it was based at the time the agreement was written.

Q. I appreciate this was between Mr. Hoffman and Mr. Fleming, but I did want to know whether you knew of that and agreed to it and what it was based on.

A. We knew of the agreement, because this was one of a series of agreements which we had gone over.

Q. And do you recall that \$12,000.00 limitation in there?

A. Frankly, right at now I am a little confused as to—apparently that was put in. I don't know how that particular figure was arrived at.

Q. But I take it that you now do not have any independent recollection on that \$12,000.00 matter at all. [274]

A. I don't recall that specific item, no.

(Testimony of Walter D. Douglas.)

Q. I appreciate it has been a long time back and you have been in a good many other things. Do you recall having any discussion at all with Mr. Hoffman that officers' salaries should not exceed \$12,000.00 during that year at least until after Mr. Fleming was paid off? A. Well, I don't—

Mr. Milliken: Your Honor, I object to that, because that is not what this agreement says. If the witness is asked if he thinks it means that, that is something else. That is not what this agreement says.

Mr. Crouter: I am not basing these questions entirely on this agreement, if the Court please.

Q. (By Mr. Crouter): On direct examination you testified to certain conversations as to arrangements you had with him, sir, and I just wanted to know whether this was a part of those conversations, whether there was any conversation with Mr. Hoffman about the \$12,000.00 limitation on officers' salaries.

A. I don't recall, as I say, this particular figure. I recall the general subject matter which led up to this portion of the agreement, but I can't tell you now whether I specifically remember the \$12,000.00 figure or not.

Q. I appreciate that the agreement is between Mr. Hoffman and Mr. Fleming. [275]

A. Yes, sir.

Q. But the situation as it is now is that you now have no independent recollection of any discussion by Mr. Hoffman or any agreement with Mr. Hoff-

(Testimony of Walter D. Douglas.)

man regarding the \$12,000.00 limitation of officers' salaries.

A. I don't recall any specific discussion of that item, no sir.

Q. I take it, then, that in view of your financial situation generally, this initial investment of \$4,000.00 was a very minor financial matter in your life, isn't that right?

A. Well, I don't know whether it is minor. I admit that it is a speculation, and there was the possibility that I entered in at the time, realizing I might never see it again.

Q. You regarded that just as a small investment or speculation on your part.

A. Relatively small, yes.

Q. Did you at any time receive any interest on any of the amounts that you advanced, Mr. Douglas?

A. Yes, I did.

Q. Do you remember whether you received any in 1942 and 1943?

A. Yes, I think there was interest paid for both of those years. [276]

Q. You did not receive anything purporting to be in the nature of a dividend on account of your contract as shown by Exhibit 7, I mean, the contract of December 9, 1941, or on account of the stock which you were to receive before it was issued in January, 1944, did you? A. No.

Q. You received nothing in the nature of dividends or payment on your agreement for the year 1943. That is correct, isn't it?

A. The only receipts were interest on the loans.

ORIGINAL
No. 12144

United States
Court of Appeals
for the Ninth Circuit

HOFFMAN RADIO CORPORATION,
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vs.

COMMISSIONER OF INTERNAL REVENUE,
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Transcript of Record

In Two Volumes

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(Pages 289 to 571, inclusive)

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(Testimony of Walter D. Douglas.)

Q. So I take it from your testimony, then, that you were not concerned at all with respect to the share, if any, that you might be entitled to of the net earnings of the Petitioner corporation here for the year 1943?

A. Well, in 1943, I was not particularly concerned with it, because I was contributing nothing to the company.

Q. You mean you were not working there.

A. No, sir.

Q. You had contributed your capital.

A. Yes, sir.

Q. And you got some interest on that.

A. Yes, sir.

Q. But you were not interested in any greater return on your capital, is that the situation?

A. Not at that time, no, sir. [277]

Q. You did follow and you could see the progress of the company from time to time up until the time you went into the service?

A. Well, I was also informed while I was in service, so I knew just what the company was doing.

Q. I suppose you had great hopes of its developing into a large corporation having substantial assets and business, and from that you might secure returns on your capital in the company.

A. That is correct.

Q. Was the position of Mr. Davidge more in the nature of an investment than as an active participant in the early stages of the development of his corporation?

(Testimony of Walter D. Douglas.)

A. Well, I don't know just how he felt about it. I mean, to a certain extent he and I both agreed that it was a speculation, but that it might prove to be something, and I think he was interested in seeing the formation of the company, and the management and the developments that were occurring. Now, whether he felt about it actually as an investment or a loan or just what light he viewed it in, I am not sure.

Q. Referring to your testimony that as an investor you considered the financial arrangement, particularly the 3 per cent with Mr. Hoffman and the 1 per cent with Mr. Harmon, to be fair, and that it would not unduly drain your capital investment in the company, did you have any idea that payments [278] to be accrued and paid to those two individuals in 1943 would aggregate about \$85,000.00 under such agreement? Did you have any idea to that effect before the end of 1941?

A. No.

Q. That went beyond your wildest dreams and expectations with respect to the business of the corporation, did it not?

A. I think it all fits into the business. We had no way of seeing that there would be that rapid growth.

Q. That was due to the war orders, was it not?

Y. Yes.

Mr. Crouter: That is all, thank you.

Redirect Examination

By Mr. Milliken:

Q. Mr. Douglas, did you also during the years

(Testimony of Walter D. Douglas.)

1942 and '43 endorse the borrowings at the bank of this corporation? A. I did.

Mr. Milliken: That is all.

Mr. Crouter: No further questions.

The Court: Let me ask you this, Mr. Witness: What branch of the service were you in?

The Witness: United States Navy.

The Court: Did you have anything to do with procurement?

The Witness: I was on board ship, my whole duties.

The Court: This is not a case where you had anything [279] to do with this company getting anything?

The Witness: No, sir. I was on a ship outside the Continental limits all that period.

The Court: That is all I have.

(Witness excused.)

Mr. Milliken: Petitioner rests, your Honor.

The Court: Petitioner rests. What says the Respondent? [280]

Mr. Crouter: Respondent is ready to proceed.

The Court: Call your first witness.

Mr. Crouter: Mr. Cranston, please.

Whereupon,

EDWARD CRANSTON

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of Edward Cranston.)

The Clerk: Tell us your name, please.

The Witness: Edward Cranston.

Direct Examination

By Mr. Crouter:

Q. Where do you live, Mr. Cranston?

A. 435 Plumosa Drive, Pasadena, California.

Q. What is your business?

A. I am in the manufacturing business. I am president of the Lumidor Manufacturing Company.

Q. How long have you been connected with that company? A. 14 years next February.

Q. What was the business of that company in 1939 and 1940?

A. Well, we were making lighting products as we do now; floor lamps, table lamps and fluorescent desk lamps, and in 1940 fluorescent fixtures for offices and factories.

Q. Do you know Mr. H. L. Hoffman who is in the court [281] room?

A. Yes, sir, I do.

Q. When did you first become acquainted with Mr. Hoffman?

A. I believe it was early 1939. Through a mutual friend I was introduced to Mr. Hoffman.

Q. Did Mr. Hoffman ever have any connection with the business of Lumidor Manufacturing Corporation?

A. Well, he acted in the capacity of sales agent for us from May, 1939, until the end of 1940.

Q. From May, 1939, to the end of 1940?

A. That is right.

(Testimony of Edward Cranston.)

Q. Will you please tell the Court in a little more detail as to how that started and exactly what was the relationship and what, if any, business was handled through that arrangement?

A. Well, in 1939 we were making floor lamps and table lamps, distributing them through the various power companies in the state, P. G. & E. and Southern California Edison, and Mr. Hoffman had a fluorescent desk lamp that he had brought in from the east. He brought it in to us in search of a western manufacturer to produce it, and he was interested in the sale of it. We as a company weren't too enthusiastic about it because it more or less conflicted with our power company business. However, Mr. Hoffman was so enthusiastic about the thing we did go in and make models and Mr. Hoffman took [282] over the sale of it on a commission basis, 10 percent commission on gross billings, and that carried on until 1940, through 1940. The thing started to grow, as I remember, and we asked Mr. Hoffman if he couldn't devote his full time to it, and he didn't want to do that. That is why it was terminated.

Q. Was Mr. Hoffman at any time in 1939 or 1940 a regular employee of the Lumidor Manufacturing Company?

A. No, he was never shown on our payroll records as an employee. We issued a commission check twice a month.

Q. The arrangement was solely on commission basis?

A. That is right, yes.

(Testimony of Edward Cranston.)

Q. Can you tell the Court from original records of your company what, if any, amounts of commissions were actually paid to Mr. Hoffman during the period you have stated?

A. Yes, I have it here.

Q. Will you please do so? Give us the original—the commencing dates first for the year 1939 and the last date in that year and the total amount for the year, if you can, Mr. Cranston.

A. The commencing date in 1940—

Q. Let's take 1939 first.

A. It was May 1, 1939. During the seven months of 1939 we paid Mr. Hoffman \$1,351.19. The closing date in 1940 is 12-15, and during that year, the whole year, we paid Mr. Hoffman \$3,532.85.

Q. Your reference to 12-15 means December 15, 1940?

A. That was the last check issued to Mr. Hoffman, yes.

Q. I see. Were there any other sums paid to Mr. Hoffman as commissions or for any other reason or service performed during that period?

A. No, that is all the checks we ever issued to Mr. Hoffman.

Q. Please tell the Court whether or not Mr. Hoffman was regarded on your records as a full time employee or on some other basis.

A. Well, on this ledger sheet I see a notation "Sales Agent", so he would not have been regarded as an employee. As I remember it, he paid his own expenses and financed himself out of his own funds.

(Testimony of Edward Cranston.)

Q. Do you know during those years, Mr. Cranston, whether Mr. Hoffman in fact had any other line, if I may refer to it as such, that he was interested in or promoting, or, I mean any other business that he handled during those years?

A. Yes, I knew he was handling the sale for Peerless Electrical Products. They were a local manufacturer of transformers. I don't know just when that connection was made by Mr. Hoffman, but as a matter of fact, we bought a lot of transformers through Mr. Hoffman.

Q. Was that work on behalf of Mr. Hoffman agreeable to you and your corporation? [284]

A. Oh, yes. As I say, we bought transformers from him.

Mr. Crouter: You may examine.

Cross-Examination

By Mr. Milliken:

Q. You say Mr. Hoffman brought this fluorescent lamp, is that right, to you?

A. He brought it to my attention. Of course, I had seen it, but as I stated, we weren't too interested in the thing.

Q. Did you continue to sell the lamp after the termination of Mr. Hoffman's services?

A. Oh, yes.

Q. Has it proven a successful line or unsuccessful?

A. Very successful.

Mr. Milliken: That is all.

Mr. Crouter: Nothing further.

The Court: You may be excused.

(Witness excused.)

The Court: Call your next witness.

Mr. Crouter: If your Honor please, I am sorry about the situation that has developed with respect to my next witness. He is a man who is pretty busy, and I told him I thought it would be safe not to come before 2:00 o'clock. I am sorry for that, because I had understood from Mr. Milliken that he would occupy the whole forenoon. There is only one [285] more witness, and it will not be over an hour, I am certain as far as I am concerned.

The Court: Of course, we are very busy as well as the witness. We try to keep busy. I don't think you are justified under the circumstances in telling your witness not to be here until 2:00 o'clock. Could you get in touch with him and have him come sooner?

Mr. Crouter: I believe he can make it by 1:30, if it is agreeable.

The Court: We will be recessed until 1:45.

(Whereupon, at 12:07 p.m., a recess was taken until 1:45 p.m. of the same day.) [286]

Afternoon Session, 1:45 p.m.

The Court: Proceed with the case on trial.

Whereupon,

S. W. GILFILLAN

called as a witness for and on behalf of Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of S. W. Gilfillan.)

The Clerk: Tell us your name, Mr. Witness, please.

The Witness: S. W. Gilfillan.

Direct Examination

By Mr. Crouter:

Q. Mr. Gilfillan, please tell the Court where you reside. A. Los Angeles.

Q. How long, approximately, have you resided in or around Los Angeles, California?

A. 57 years.

Q. What is your present business?

A. Manufacturing.

Q. Manufacturing what?

A. Electronic equipment, radar, aircraft mechanical parts and household radios.

Q. How long have you altogether been in the business of the manufacture of household radios?

A. Since 1922.

Q. What is the name of your present business firm? [287] A. Gilfillan Brothers, Inc.

Q. When was that incorporated?

A. 1917.

Q. Has that been a corporation continuously since that time? A. Yes.

Q. In 1942 and 1943 Gilfillan Brothers in active business in and around Los Angeles?

A. Yes.

Q. Please tell us as of the first part of 1942 where that business was located?

A. 1815 to 1825 Venice Boulevard.

Q. Is that still the business location?

(Testimony of S. W. Gilfillan.)

A. Yes.

Q. Now, going back to the period around the beginning of 1942, what was the nature of the business as far as the production was concerned?

A. The start of 1942—we were manufacturing radios, we were manufacturing aircraft precision parts, hydraulic parts.

Q. Was there any particular change in the nature of the business due to the entry of the United States into the World War on or soon after December 8, 1941?

A. Will you repeat that question, please?

Mr. Crouter: Read the question, please. [288]

(The question was read.)

The Witness: The military work was accelerated and the peace time work tapered off.

By Mr. Crouter:

Q. What is the accounting basis and what was the accounting period of the corporation for the year 1943?

A. Our accounting is on a fiscal basis, and the fiscal year closes May 31st.

Q. Have you produced and do you have with you any summaries and accounting records or summaries of records relating to the business of that corporation, I mean, Gilfillan Brothers, for the fiscal year 1943? A. Yes.

Q. Tell the Court what kind of an accounting record it is and who prepared it and so forth.

A. Well, the report I have is a report by Ernst & Ernst, accountants. That is it.

Q. Were you continuously with the corporation so that you knew what was going on during the fiscal year 1943? A. Yes.

(Testimony of S. W. Gilfillan.)

Q. What was your position, Mr. Gilfillan?

A. President.

Q. How long had you been president? When were you first made president of the corporation?

A. I started the business in 1917. [289]

Q. Since 1917. What in general did you do, what were your duties and so forth in a general way with respect to the operation of the business during the fiscal year 1943?

A. Well, to start out, to decide what type of business and the amount of business we would accept, to see that the business was carried on and deliveries were made and collections made and our contracts fulfilled.

Q. Now, during that fiscal year, do you have any summary relating to all of the customers or corporations with which Gilfillan Brothers had contracts which were in an active course of manufacture during that fiscal year? Do you have a summary of those?

A. I have a list here of our customers, prime customers, for the fiscal year ending 1943.

Q. You say "prime customers"?

A. Yes. I think that the small petty sales are not included in this or else they were lumped in somewhere.

Q. Now, referring to this document which relates to a period ended May 31, 1943, please tell the Court whether there are any subcontracts included in there. I mean, subcontracts with Gilfillan Brothers.

(Testimony of S. W. Gilfillan.)

A. All sales made from this list of customers were subcontracts, except those to the United States Army Air Force, the United States Army Signal Corps and the U. S. Navy.

Q. All except the fourth, fifth and sixth ones from [290] the bottom of the list, is that right?

A. Correct.

Q. Do you have additional data with you so that if we get into it, you could tell the Court approximately what amount or the exact amount of business done with each of those corporations and the total amount with all of them for that period?

A. Yes.

Mr. Crouter: I offer this list, if the Court please, at this time. I will follow this up with other testimony.

Mr. Milliken: I am going to ask the purpose of counsel in offering the list.

Mr. Crouter: Yes. The purpose, if the Court please, is as I will try to develop here, to show the business, the kind of business done in this fiscal year, and I will supplement it, if allowed to, with additional data on the calendar year basis to show the volume done during the calendar year 1943 and also to show the officer setup and compensation allowed to those officers, deductions by them and so forth as expenses of Gilfillan Brothers for the fiscal year 1943 as a basis of comparison with the Petitioner's position in this case.

Mr. Milliken: That brings up a very vital point, it seems to me, your Honor, and I should like to have the [291] opportunity of making a motion at

(Testimony of S. W. Gilfillan.)

this time, and my reasons in support of it. I object to counsel for the Respondent offering any evidence with respect to what any company did in the year 1943. My position is that here we have a contract, employment contract entered into on December 4, 1941. As I see it, the judicial inquiry should concern itself with first, was that a bona fide contract entered into, was it entered into at arm's length and was that contract fair on its terms when entered into in 1941. If we reach the affirmative with respect to each of those inquiries, then, under the Commissioner's own regulations, approved by the Secretary of the Treasury, which has the force and effect of law, because they have been unamended for years upon years, we are unconcerned when we get into 1943 if per chance the compensation should have been greater than even the parties contemplated in 1941 or greater than maybe a straight employment contract should be without an incentive basis.

The Court: Of course, you may be right on that contention as to the contract. As a matter of fact, I find this a rather interesting case in that regard, and I will somewhat look forward to your briefs on that question, but I don't think that I should at this time bar evidence on the other issue. It may well be that I would base the opinion, when I write it, upon that ground. I don't know, but I don't want to deprive myself now of evidence in case I should conclude that you are [292] wrong about that point. I think that it shows a very interesting question, but I won't sustain your motion at this time. I

(Testimony of S. W. Gilfillan.)

will hear this evidence, and if I should conclude that you are right, of course, there will be no object, and I don't even know that I would go into other evidence, or I might put it upon both grounds, but I don't think I should deprive myself of evidence in case I should conclude you are wrong on that. Your motion is overruled, and an exception will be allowed the Petitioner.

I take it that there is no objection because this is not the original instrument? You didn't mention that.

Mr. Milliken: No, I am sure that Mr. Gilfillan has a reputation in the community that he wouldn't bring something that wasn't true.

The Court: The instrument is admitted in evidence as Respondent's Exhibit F.

(The document above-referred to was received in evidence and marked Respondent's Exhibit F.)

[Printer's Note]: Respondent's Exhibit F is set out in full at page 477 of this printed Record.

By Mr. Crouter:

Q. Now, Mr. Gilfillan, have you made certain summaries and can you give or show to me a summary of the earnings and any profits or loss statement of the Gilfillan Brothers for the same fiscal year ended May 31, 1943? A. Yes.

Q. Tell the Court in general how that was prepared and [293] who prepared it.

(Testimony of S. W. Gilfillan.)

A. In 1943—our accounting department keeps our books. Ernst & Ernst audits our books. During the war time when so many war contracts were on, they were practically continuously in our place keeping our records in order and in balance with the different contracts.

Q. Now, does the summary which you hold in your hands reflect any amounts of receipts upon contracts—

Mr. Milliken: Now, if your Honor please, I think I should make the same objection Mr. Crouter did to me, and I thought he was valid in making it. Let's introduce the evidence without having him read from something. I don't know whether that is going in evidence or not.

The Court: Let's not more than identify the instrument before going into it.

Mr. Crouter: That is only half of my question, but I will withdraw that.

By Mr. Crouter:

Q. I will ask you to state to the Court what, if any, relationship there is between Exhibit F and the facts and figures shown in the document labeled "Profit and Loss Statement".

A. The list of customers in Exhibit F purchased the total amount of the annual sales of \$3,695,822.57.

Mr. Milliken: Excuse me, Mr. Gilfillan. Would you [294] read that over just a little slower, please?

The Witness: The amount?

(Testimony of S. W. Gilfillan.)

Mr. Milliken: Yes, the three million.

The Witness: \$3,695,822.57.

Mr. Milliken: Thank you.

Mr. Crouter: It may be, if the Court please, I had better get an identification number on this. I believe it will facilitate the proceeding.

The Clerk: Exhibit G.

(The document above-referred to was marked Respondent's Exhibit G for identification.)

The Court: I take it that the amount just named by the witness appears on this Exhibit G for identification?

Mr. Crouter: I believe it does, if the Court please.

By Mr. Crouter:

Q. Do the amounts you just read occur on Exhibit G for identification? A. Yes.

Q. Now, please tell the Court whether Exhibit G for identification reflects the total amount of net sales of the corporation for the same fiscal year.

A. No, the sales were decreased by \$200,000.00 due to renegotiations of sales prices and refund to the government of \$200,000.00.

Q. Then, it does reflect the final figure or sales after [295] that adjustment?

A. \$3,495,822.57.

Q. Now, Mr. Gilfillan, without reading any particular figures into the record here, please state whether all of the various items and the figures opposite such items are based upon the original

(Testimony of S. W. Gilfillan.)

books and records of Gilfillan Brothers for that period. A. They are.

Q. Were all of such entries made in the regular course of business? A. Yes.

Q. Was it the regular practice of your business and the regular course of business to keep such permanent records and have such entries made?

A. Yes.

Q. Please tell the Court whether this is a correct summary of such records and figures.

A. Yes, it is.

Mr. Crouter: I offer Exhibit G for identification in evidence.

Mr. Milliken: No objection in line with your Honor's ruling.

The Court: Respondent's Exhibit G is admitted in evidence.

(The document heretofore marked Respondent's Exhibit G was received in evidence.)

[Printer's Note]: Respondent's Exhibit G is set out in full at page 479 of this printed Record. [296]

The Court: You may have, if you wish, an exception to this entire line of testimony.

Mr. Milliken: No, your Honor, I quite agree with your Honor's ruling, but I felt because of my strong conviction on the question of law I should make the motion I did for the purpose of the record.

The Court: Very well.

(Testimony of S. W. Gilfillan.)

Now, I am wondering this: Mr. Crouter very carefully made the usual proof of the authenticity of this instrument, of its being made up in the usual course of business and so forth. Judging from your statement a moment ago, Mr. Milliken, that you were not in any doubt about this other exhibit, I wonder if it is necessary to go through that matter and that fine type of proof with each instrument.

Mr. Milliken: It will be perfectly permissible with me, that is, so far as counsel is concerned, subject to your Honor's approval, that he need not go into that as far as I am concerned if Mr. Gilfillan states from the witness stand that it is an accurate reflection of his records.

The Court: That is all I had in mind.

Mr. Crouter: Thank you.

By Mr. Crouter:

Q. Mr. Gilfillan, please tell the Court what the business of the corporation was after the date May 31, 1943, in a general way, and how it corresponded with respect to the [297] business done from January 1, 1943, down through May 31, 1943, with respect to the volume, particularly volume of sales.

Mr. Milliken: I object to that, your Honor, unless counsel limits it to December 31, 1943.

Mr. Crouter: I thought I had, through the end of that calendar year.

Mr. Milliken: You had not so stated.

Mr. Crouter: I am glad to have that corrected and included.

(Testimony of S. W. Gilfillan.)

The Witness: For the calendar year the total sales amounted to \$5,625,275.00.

By Mr. Crouter:

Q. And, as I understand it—

A. With that—

Q. Go ahead.

A. That figure is prior to a reduction of \$200,000.00 in the sales due to renegotiations.

Q. Now, as I understand it—

Mr. Milliken: I know you are trying to get the record right. I want to be sure I am clear. Are you taking now from January 1st, Mr. Gilfillan?

The Witness: Yes, sir.

Mr. Milliken: And taking it to December 31st?

The Witness: The last figure is our sales for the [298] full calendar year for 1943.

Mr. Milliken: That is assuming you were on the calendar year basis?

The Witness: No, I just picked the sales off from the two fiscal years' statements.

Mr. Crouter: Mr. Milliken, I believe I can develop this if you will just give me an opportunity.

Mr. Milliken: Well, I object, then, to not having the best record. I am sorry that I have to make that objection.

By Mr. Crouter:

Q. Mr. Gilfillan, may I see a summary that you just read to me?

A. One of these exhibits (indicating)?

Q. The total five million dollar figure. Do you have that down here? A. Yes.

(Testimony of S. W. Gilfillan.)

Q. Now, please refer to any accounting books or records or summaries which you have with you showing the exact figures, if there are any, that are included making up the total of \$5,625,275.00.

A. The exhibit you have looked at is a statement given to me by the accounting department in total round figures.

Q. Your own?

A. It is not broken down monthly, and I have taken [299] those figures from the chief of our accounting department.

Q. Do you have any accounting records which do break down the sales figures month by month?

A. Oh, yes. Are you asking me if I have them with me?

Q. Yes. A. Yes.

Q. Do you have such figures for the entire calendar year 1943? A. Yes.

Q. So that a person could examine and see the total for each month, and would they show the companies from which such amounts were received each month, each particular company going into each figure?

A. The figures will show the total for each month and the customer that the billing was made against by months.

Q. In general, would those be the same identical customers as shown by Exhibit F in evidence?

A. Exhibit F placed in evidence is the customers in the fiscal year closing May 31, 1943. When we consider the customers for the calendar year, the

(Testimony of S. W. Gilfillan.)

list will vary undoubtedly due to the fact that seven months of the calendar year 1943 was on this statement. The other five months would come off of a different list of customers.

Mr. Crouter: May I have this document marked for identification? [300]

The Clerk: Exhibit H for identification.

(The document above-referred to was marked Respondent's Exhibit H for identification.)

By Mr. Crouter:

Q. Now, what, if any, relationship is there between H for identification and any authentic accounting records which are available to you here in Court? A. They are identical.

Mr. Crouter: I offer Exhibit H for identification.

Mr. Milliken: It has already been offered for identification.

Mr. Crouter: I mean I offer it in evidence at this time.

Mr. Milliken: Then, I object on the grounds it is not the best evidence.

Mr. Crouter: Because the books and records are not here?

Mr. Milliken: I don't know about this breakdown, whether Mr. Gilfillan has gone through all those months or not month by month.

The Court: Of course, the objection will have to be sustained. The summaries are very valuable in Court, but of course, they have to be substan-

(Testimony of S. W. Gilfillan.)

tiated or potentially substantiated by the original records being in Court for purposes of cross-examination. The objection will be sustained. [301]

By Mr. Crouter:

Q. Now, Mr. Gilfillan, please tell the Court who the other officers of Gilfillan Brothers were, if there were any, for the fiscal year and during the calendar year 1943.

A. J. G. Gilfillan was vice-president; I. B. Sparks, vice-president; A. J. Brown, vice-president; I. Kemp, secretary and treasurer.

Mr. Milliken: Pardon me, Mr. Gilfillan. I want to write this and I can't write that quick. I have gotten as far as A. J. Brown, vice-president. What was the next one?

The Witness: I. B. Sparks. Did you get that?

Mr. Milliken: Yes.

The Witness: I. Kemp, secretary and treasurer and J. H. Miles, vice-president.

By Mr. Crouter:

Q. What was Mr. Miles' position?

A. Miles was production radar and electronics.

Q. Now, Mr. Gilfillan, could you proceed in your own case and with these other officers whom you have mentioned and advise the Court with respect to the amount of compensation, if any, that such officers received from Gilfillan Brothers during 1943? I say, are you prepared, first? Just answer yes or no.

A. Yes.

Q. Do you know of such matters of your own knowledge? [302]

A. Yes.

(Testimony of S. W. Gilfillan.)

Q. Please tell the Court in your own case what your total compensation was from Gilfillan Brothers for the entire calendar year 1943.

A. The salary was \$32,432.40, and that was the total compensation.

Q. I don't mean to confuse the accounting periods now. Is that your figure for the fiscal year or have you been able to analyze that?

A. It would be just the same. I have never changed my salary.

Q. It has been the same? A. Yes.

Q. How long has it been the same?

A. Oh, with a slight fluctuation for 15 or 20 years.

Q. Now, with respect to Mr. Sparks, will you tell the Court what his total compensation was from the corporation during 1943? A. \$14,999.92.

Q. What was Mr. Brown's total compensation for the year 1943? A. The same, \$14,999.92.

Q. What was Mr. Kemp's total compensation?

A. Miss I. Kemp.

Q. Excuse me. [303] A. \$4,252.22.

Q. What was Miles' compensation?

A. \$8,400.08.

Q. Please tell the Court a little more than we have indicated so far the duties of Mr. Sparks for the corporation for the year 1943, and make it on the calendar year. Just tell us as nearly as you can recall exactly what he did in a general way.

The Court: What was Sparks' position?

Mr. Crouter: Yes.

(Testimony of S. W. Gilfillan.)

The Court: What was Spark's position?

The Witness: Vice-president.

The Court: Vice-president?

The Witness: Sparks had control of production, flow of materials and to a certain extent contact with customers in the aircraft division of our business, the mechanical production of hydraulic parts and so forth for military planes.

By Mr. Crouter:

Q. First, were all of these full time officials or officers of the company? A. Yes.

Q. Now, in Mr. Brown's case, what did he do, if anything?

A. Brown was the contact man with the accounts and gave Sparks instructions as to priorities and checked on the [304] production records and costs in the aircraft division with the result of having knowledge to guide the department in an overall position.

Q. I notice Mr. Kemp's position was secretary-treasurer. Please tell the Court in a general way of the nature of the work that he actually did during the calendar year 1943.

A. I. Kemp is a lady.

Q. Excuse me.

A. Her duties were the usual duties of a secretary and treasurer. Under her came the credit manager. She verified bank balances and kept the minutes of the meetings and called directors' and stockholders' meetings and so forth.

Q. What were the duties of J. H. Miles?

A. He was production and material control, planning in the electronic division of our business.

(Testimony of S. W. Gilfillan.)

Q. Will you tell the Court with respect to the various officials that we have mentioned here, approximately how long they had been with the company in 1943, or, you can make it as of today and we can compute the time, of course.

A. Sparks came to work in 1920, Brown came to work about 1930, J. H. Miles came to work about 1930, I. Kemp came to work about 1920.

Q. Now, with respect to Mr. J. G. Gilfillan. About how long has he been with the company?

A. He was one of the original brothers that started the [305] organization.

Q. You mean since— A. 1913.

Q. 1913. Please tell the Court what, if any, dividends were paid as such during the year 1943, or for that year, and I will make that on your fiscal year basis. That would be for the fiscal year ended May 31, 1943.

A. Total dividends of \$22,354.38.

Q. Now, please tell the Court whether any of the officers whom you have named were also stockholders of the corporation, and if so, indicate the approximate percentage of stock owned by each. Start in your own case, please. I would like to have that also for the year 1943.

A. S. W. Gilfillan owns 10,933.95 parts of common stock.

Q. Well, what was the total issued and outstanding? Do you have that? A. Yes.

Q. Do I understand that is ten thousand plus shares?

(Testimony of S. W. Gilfillan.)

A. The total number of shares outstanding was, common, 29,833.5.

Q. During 1943 was there any preferred stock also outstanding? A. Yes.

Q. Are you prepared, Mr. Gilfillan, so you could tell [306] the Court in percentages so that they would be absolutely correct or substantially correct, and tell us the percentage of common and preferred stock of each officer which such officer had in 1943?

A. Well, I can give you the exact amounts and it will just take a second here.

Q. Suppose you do it.

A. J. G. Gilfillan had one share of common and fourteen hundred shares of preferred; A. J. Brown, seventy-nine shares of common; I. B. Sparks had one hundred thirty-six shares of common and two of preferred; J. H. Miles had none, and I. Kemp had forty common.

Q. Now, that covers all of the officers you named, I believe. A. Yes.

Q. How much total preferred stock was outstanding, if you know? A. Yes. 4,480 shares.

Mr. Crouter: You may examine.

Cross-Examination

By Mr. Milliken:

Q. Mr. Gilfillan, it is in evidence in this case as exemplified by Exhibit 21 attached to the stipulation of facts, the earnings and gross income of the Mission Bell Radio Company. You will observe the first year is 1932. You give [307] the various sales and we come down to the year 1941 where

(Testimony of S. W. Gilfillan.)

they had a gross income of \$29,763.82. The next column to the gross income shows the net income. You will observe for 1932-33 they had losses, slight income down to the year 1939, had a loss in 1939 of \$8,275.58, a loss in 1940 of \$11,891.50 and in 1941 a loss of \$15,470.54.

Now, if we will turn back to Exhibit 9 also in the same stipulation of facts, it shows that at June 1st in the first column, 1941, they had a red figure or a deficit in earning surplus of \$19,183.25. By December 31, 1941, they had a deficit in earned surplus of \$48,786.43. A. Right.

Q. You may or may not have known of those facts. Did you?

A. I was not aware of their profit and loss statement.

Q. It is also in evidence in the case, Mr. Gilfillan, that in December, 1941, the company not only being in a deficit position was in extreme financial difficulties? A. That is right.

Q. Through a loss from these figures. It also has been shown in evidence by the other witness that they had an insignificant but small inventory of goods on hand. It has been shown by the evidence that they had a license from the Radio Corporation of America calling for a minimum guarantee of \$5,000.00 per year. It has also been shown in evidence that [308] they were in default with respect to the payment of that minimum license. It has also been shown in evidence that if that license was in default and they didn't pay it, they could lose their license.

(Testimony of S. W. Gilfillan.)

Now, that is the situation that we find ourselves confronted with in December, 1942, of Mission Bell. You had known of the company here, of course?

A. For many years. I built all their radios up to the end of 1939.

Mr. Crouter: I take it you meant December 31, 1941?

Mr. Milliken: Thank you. I am concerned in all these questions with 1941.

The Witness: That is correct.

By Mr. Milliken:

Q. Now, it has been shown from the evidence that Mr. Hoffman became acquainted with this company in December of 1941, and was able to get some financial backers to go into it with him. He bought up all the stock of Mission Bell in December, the first few days of December, 1941, for a nominal consideration, I have forgotten the amount.

About how much was that all told, Mr. Hoffman?

Mr. Hoffman: \$11,750.00.

By Mr. Milliken:

Q. He agreed to pay for the stock, all of the stock, to pay for that on a basis of \$100.00 a month, and if at any [309] time he wanted to throw it up prior to in February of 1942, why, he could throw it up and the deal was off. He got these financial backers to get in who likewise agreed to advance, one backer \$4,000.00, another \$4,000.00 and Hoffman was going to put in \$2,000.00 or \$10,000.00 to start out.

(Testimony of S. W. Gilfillan.)

It is also in evidence that the other financial backers were men of financial means in this community. They were prepared to put in more if necessary. It is also in evidence that these gentlemen did not desire to pay a large salary because the corporation had insufficient working capital, but rather to put a contract on an incentive basis, that is, if they made money, pay a salary, if they didn't make money, the corporation wouldn't be further obligated.

To that end they agreed that Hoffman would take a nominal salary and in addition thereto he would be entitled to 3 percent of the gross sales of the corporation. That was to be his entire compensation.

Also it is in evidence, and very important, I think, in propounding this hypothetical question to you, Mr. Gilfillan, Mr. Hoffman owned only 50 percent of the stock, those that were financially backing him owned 50 percent, so Hoffman didn't own control of the corporation so far as stock outstanding was concerned.

Now, bearing in mind the financial condition that I have shown you where sales dropped down to \$29,000.00 in [310] 1941—it is further in evidence they had a cost of sales of \$30,000.00, so they lost even a thousand dollars on sales—in your opinion, would that be a fair basis for compensation for a man who was to be the general manager and director of this corporation, to take over and try to operate this business?

(Testimony of S. W. Gilfillan.)

Mr. Crouter: Now, before answering that, Mr. Gilfillan—

If your Honor please, I very respectfully object to the question and I will state the reasons and grounds. I do not object because the man is not a qualified or experienced man in the radio electronics field. I find it a little bit embarrassing to object to such testimony by a witness I have called, but I object to it on the ground that it is, first, not proper cross-examination. I have assumed that he is making the witness his own for his own purpose, and I object to it because, in my opinion, it is very far from a proper hypothetical question to propound to his own witness. It has not been shown that this witness is familiar at all with the stipulated facts here. I very respectfully, Mr. Milliken, object on the ground that even in this excellent summary of yours, you have not included enough of the real substantial elements in this case so that Mr. Gilfillan would have a proper conception of the facts before his Honor in this case. [311]

For instance, it is my recollection that there was a statement by someone on the stand that the payments under the R.C.A. license had been waived and were no longer required. I believe there is a conflict on that.

Now, counsel has stated his idea of these minimum payments to Mr. Hoffman—

Mr. Milliken: Will you let me interrupt you with respect to the first point?

Mr. Crouter: Yes.

(Testimony of S. W. Gilfillan.)

Mr. Milliken: Now, under the license, Mr. Hoffman categorically testified that it had not been waived in 1941, but he did testify that after the freezing order on radios in April, 1942, and after that R.C.A.'s practice generally was to waive them because we were in the war.

Mr. Crouter: Now, going further with the objection, helping to illustrate the point that Mr. Milliken may have one understanding and one recollection of the record and I may have another—the reporters, of course, have the most accurate transcript of what has transpired—but going further with my objection, counsel has referred to the very nominal salary of Mr. Hoffman. Now, I don't know, certainly Mr. Milliken right now, certainly your Honor right now does not know whether nominal salary to Mr. Hoffman means the same to Mr. Gilfillan. How is Mr. Gilfillan to know whether that is \$100.00, \$1,000.00 or \$10,000.00? That is just a good example [312] in my opinion of my point, that this is not a proper hypothetical question, and it does not sufficiently, even in a general way, comprehend the vital facts of the case so that Mr. Gilfillan could make a good responsive answer which would be helpful to the Court in deciding this question.

The final ground is that it comes very close to usurping the functions of the Court with respect to the point in issue, and that is, what is reasonable in this case. I believe the Court is much better able to determine that even without an expression

(Testimony of S. W. Gilfillan.)

of opinion of this witness based on the inaccurate summary of Mr. Milliken.

Mr. Milliken: Well, if your Honor please, I think counsel's remark is well taken so far as salary is concerned, and I will supply that deficiency so that the witness may have that.

The Court: Of course, an answer to a hypothetical question, particularly one of opinion evidence is worth just as much as the basis laid. At least, it seems to me that that follows, and if your basis is not as broad as you wish, I will permit you to broaden it if you wish to interrogate the witness further. Before you do that, however, I want the reporter to read me the latter part, you might say the vital part of Mr. Milliken's question after he had summarized the facts. Read me the latter part of his question.

(The question was read.) [313]

The Court: Very well. Now, as I stated before, if you wish to broaden your basis of your hypothetical question, I will give you that opportunity. I think, however, the first thing that I should devote my attention to is to whether this is proper cross-examination. It seems to me it isn't unless he makes this witness—he has asked nothing about this company, he was asked about his own company, and it seems to me that this is not proper cross-examination.

Mr. Milliken: Well, your Honor, it seemed to me the fair inference, and I am sure it is not difficult for any of us to divine what Mr. Crouter has

(Testimony of S. W. Gilfillan.)

in mind by calling Mr. Gilfillan. He is going to say that here is a company that does the business which he had in mind, which the officers received the compensation which he had in mind, which the officers performed the duties which he had in mind, and therefore that is a reasonable standard for your Honor to follow on the basis of what would be a reasonable salary in the case before you.

The Court: You point out that he was attempting to set up a comparative?

Mr. Milliken: Yes.

The Court: And if the mere fact that he was setting up a comparative by asking this gentleman about his own company, if that is sufficient to make this proper cross-examination, when you ask him a hypothetical question based upon the [314] Petitioner's company and the facts that you set forth, then, of course, you are right. But I don't believe that is sufficient to make this proper cross-examination. I think you would have to make this man your own witness for asking him a hypothetical question as to the Petitioner company, and I will so rule.

Mr. Milliken: I should like to ask if I am correct in my assumption of the purpose for which Mr. Crouter offered Mr. Gilfillan's testimony in chief.

Mr. Crouter: I agree that the purpose is as stated by the Court.

Mr. Milligen: Then I wish to except your Honor's ruling.

(Testimony of S. W. Gilfillan.)

The Court: Take your exception. You may be right. I don't think you are.

Mr. Milliken: Then I will call Mr. Gilfillan as my own witness and I will propound this hypothetical question to him.

The Court: Well, do you need to repeat it except what you wish to add? I don't require you to repeat your question. You can go ahead and add anything you wish to it, but I see no object in going back and repeating it. We will consider that the question has been asked of him as your own witness.

Mr. Crouter: That is entirely agreeable to me.

(Witness withdrawn.) [315]

Whereupon,

S. W. GILFILLAN,

recalled as a witness for and on behalf of the Petitioner, having been previously duly sworn, was examined and testified further as follows:

Direct Examination

By Mr. Milliken:

Q. I wish to add to that statement of mine, Mr. Gilfillan, that Mr. Hoffman was paid a salary of \$8,000.00 in 1942 and \$8,800.00 in 1943, a fixed salary. A. And three percent?

Q. And three percent.

The Court: Now, you are asking for an answer with that addition?

Mr. Milliken: Yes, I am.

The Witness: I think—

(Testimony of S. W. Gilfillan.)

The Court: In all fairness, now, I don't think cases ought to go off on technicalities.

Are you objecting to this question as reframed?

Mr. Crouter: Yes, I stand by my objection, if the Court please.

The Court: I really shouldn't have to put it that way, but nevertheless I don't think anyone wants this case to go off on a mere fact that an objection was not made after it was once made, and that is the reason I presumed to ask whether there was a question. The objection is overruled, exception allowed, and as I said before, the answer to a hypothetical question, in my opinion, is worth as much as the basis laid. If I should conclude that you didn't have the full proper basis, I will have to consider that. Answer the question. [316]

The Witness: I think it was a good contract for the corporation.

By Mr. Milliken:

Q. You think it was a good contract for the corporation? A. I do.

Q. You mean you think it is a fair and equitable basis for compensation?

A. At that particular time.

Mr. Crouter: I object on the ground that it is leading and counsel is doing the testifying.

The Witness: Yes—

The Court: Just a moment, Mr. Witness. That is leading, of course.

Mr. Milliken: Well, he says it was a good contract, and I think "good" ought to be defined.

By Mr. Milliken:

(Testimony of S. W. Gilfillan.)

Q. Then I will ask you what you mean by "good"?

Mr. Crouter: May I have the last question and answer stricken?

Mr. Milliken: That is quite proper, I agree to that.

The Court: Strike the last question and answer.
By Mr. Milliken:

Q. What do you mean by "good", Mr. Gilfillan?

A. Fair and equitable. [317]

Q. To the corporation? A. That is right.

Q. And to its stockholders as well?

A. Well, that is the stockholders.

Q. Mr. Gilfillan, if Mr. Crouter asked it, it slipped my mind. Were you paid \$32,432.40?

A. As salary.

Q. Salary. Your brother J. G. Gilfillan?

A. Ten thousand—wait a minute. It is on that. I will get it for you.

Q. I don't believe it is on this. I didn't get that figure.

A. I don't think anybody asked for it.

Q. I don't believe Mr. Crouter asked it.

Mr. Crouter: I am sorry. I intended to.

The Witness: The salaries paid in 1943. \$10,500.00.

By Mr. Milliken:

Q. Mr. Gilfillan, have you added up the entire salaries of yourself, J. G. Gilfillan, Sparks, Brown, Kemp and Miles? A. Yes.

Q. What does the total amount to?

(Testimony of S. W. Gilfillan.)

A. \$85,796.32.

Q. Now, Mr. Gilfillan, addressing your attention to Exhibit G of Respondent, I noticed here you have "general and administrative, \$313,030.33." [318]

A. That is right.

Q. I find, if my calculations are right, that that is 8.66 percent of gross sales.

A. Well, do you want me to accept your figure?

Q. No. If I am right about that, general and administrative expense was \$313,030.33.

A. 8.47 percent.

Q. That is what it was, 8.47 percent. I was off on a percentage basis. I don't know, but the figure will speak for itself.

Now, in the exhibit in this case, the case of the Hoffman Radio Company, Exhibit 2, we find that for the year 1943 they had a general and administrative expense of \$116,861.75, or 6.3 percent of the gross sales, or there being a differential between yours and theirs of the amounts indicated.

It is also in evidence in the case pursuant to a stipulation, that the net sales of the Hoffman Radio Corporation for the year 1943, after renegotiations, were \$1,787,850.14. Do you believe that your company operated as economically as possible so far as general and administrative expenses were concerned in the year 1943, Mr. Gilfillan?

A. Yes. I would like to state this: That this 8.47 percent is for five months of the year. The next fiscal year had a percentage of 5.52 percent, which took in seven [319] months of that calendar year.

(Testimony of S. W. Gilfillan.)

Q. Yes. Well, it is true, isn't it, Mr. Gilfillan, as a businessman, that the larger your sales, the less will be your general administrative expenses?

A. Generally speaking. Of course, it all depends upon the nature of the business.

Q. Yes. But that would be true in your business, wouldn't it? A. Yes.

Q. Well, the point I am bringing out is that you had sales for the fiscal year ended May 31st after deductions for renegotiations of \$3,695,822.57 as against sales after renegotiations of Hoffman Radio of \$1,787,850.24, and there is that disparity. Would that impress you as to whether or not the general salaries and compensations paid in the Hoffman Radio Company in 1943 would be reasonable or unreasonable?

A. It really doesn't give me any basis to pass an opinion, because the business may have very high general and administrative expenses in one department and very low in another, and it depends upon a breakdown of Hoffman's business and what department of his business was operated. The administrative expenses under military contracts went way down.

Q. Well, your administrative expenses here is for the [320] overall, isn't it, Mr. Gilfillan?

A. Yes, for that fiscal year. If you want to ask me if I think mine is efficient, the answer is yes, but I don't know anything about Hoffman's business.

Q. Well, if it was less than yours—

(Testimony of S. W. Gilfillan.)

A. I don't think that means a thing, to tell the truth. I don't think it means a thing. Some businesses can be run with practically no general overhead, percentagewise. The records will prove that. For instance, all our government contracts were based upon the auditors' statements of military auditors, and the general administrative fluctuated from 6 percent down to 3½ percent in our business during the war. Now, we were no more efficient in 1945 than we were in 1943, so if I don't know the condition of Hoffman's company, I can't give you an opinion.

Q. Well, I think the figures speak for themselves. Now, are you acquainted with the salary freezing date? A. No, I am not.

Q. You don't think—

A. I knew they froze salaries sometime during the war.

Q. It was in October, 1942, if I be not in error.

A. Probably. I am not from memory very conscious of when it happened.

Q. Did you make any request to the Salary Stabilization Board to increase any salaries in your place? [321]

A. Any salaries of officers or any salaries?

Q. Of officers. A. Yes, we did.

Q. Officers, Mr. Gilfillan?

A. Not to my knowledge.

Q. Not to your knowledge. Not after October, 1942, you made no request to increase officers' salaries?

(Testimony of S. W. Gilfillan.)

A. Until 1946 when the war was over we raised Joe Miles' salary.

Q. Mr. Gilfillan, what was the business that you had been engaged in prior to December of 1941?

A. Before Pearl Harbor?

Q. Prior to Pearl Harbor, yes.

A. Well, I said I was in the radio business. For how many years, for what year?

Q. Take it back for a year and longer than that.

A. One year?

Q. One year, for example.

A. Radio business and aircraft precision parts for military purposes.

Q. What percentage of your business prior to Pearl Harbor or for a year back would relate to aircraft precision parts and what part would relate to commercial radios?

A. Well, I haven't that record here. Do you want my estimate? [322]

Q. Your best judgment.

A. I would say in 1941, I think for the calendar year 1941 the military work was 75 percent of our business.

Q. Seventy-five percent of your business. In other words—

A. Estimated, that is, in estimated business.

Q. When did you have a fire at your place?

A. 1940.

Q. When did you rebuild your place?

A. During the first half of '41.

Q. During the first half of '41? A. Yes.

Q. You built a precision plant, didn't you?

(Testimony of S. W. Gilfillan.)

A. Well, we more or less reproduced the same plant because what we had to do was to rebuild all our machine tools and rebuild the building, so it was the same type of work, yes.

Q. That is right. You were a fully intergrated concern as of December, 1941?

A. Fully integrated. I wonder if I understand what that means?

Q. Yes. You had your radio business, you had your precision parts business, you were a functioning company at December, 1941? A. Yes.

Q. How long before that had you been in that position? [323]

A. You mean after the fire—are you talking about that time?

Q. Before.

A. Well, I would say that we were in that position from the time we started our business in 1913.

Q. Fine. Had you ever suffered any losses?

A. Financial losses in bad years?

Q. No, business losses. Had the business operated at a profit or loss?

A. On the long range it had. It had bad years and good years.

Q. I see. What would your profit from operations for the year 1941 be? A. 1941?

Q. Just in round figures?

A. Let's see if I got that.

The Court: You mean fiscal year or calendar year?

Mr. Milliken: The fiscal year.

(Testimony of S. W. Gilfillan.)

By Mr. Milliken:

Q. I suppose you have always been on the fiscal year basis? A. That is right.

Q. That would be May 1, 1941.

A. I haven't those figures with me.

Q. Could you give us just an estimate which you think [324] would be fairly accurate, Mr. Gilfillan?

A. That would be the end of the fiscal year '42?

Q. May 31, 1941.

A. Oh, we had a heavy loss that year. That was the year of the fire.

Q. I see.

A. I forget what our loss was, but it wiped out all our quick assets by the time we built the building and got our machinery set up, and we were starting from scratch at that point.

Q. But it was a loss from the fire?

A. Yes. We were on an operating basis prior to the fire.

Q. Prior to the fire on an operating basis. Then what would you say your profit from operations was for the fiscal year ended May 31, 1942?

A. From memory it seems to me that it was \$86,000.00.

Q. \$86,000.00. Was that before or after taxes?

A. After taxes.

Q. After taxes? A. Yes.

Q. Now, the total number of outstanding preferred stock was 4,480 shares, Mr. Gilfillan, as of 1943? A. 4,480 shares.

(Testimony of S. W. Gilfillan.)

Q. Now, you owned how much of the preferred stock? [325] A. 124 shares.

Q. Give me the other stockholders of the preferred.

A. Well, I haven't got a list of my stockholders here. I just brought the list of shares owned—well, maybe I have. All right, I have got them.

Mr. Crouter: If your Honor please, I object to that on the ground of its immateriality and irrelevancy unless counsel can show me otherwise. I don't see that it has any real bearing on the case.

The Court: Objection is overruled. I think it has some bearing.

The Witness: Let's see. I think I got them. Well, I don't seem to have them, I am sorry to report. I will look through here in a minute, and I will see. I have them for the officers—no, I don't have them.

By Mr. Milliken: Q. Do you have it for the common stock, Mr. Gilfillan?

A. No, I just have the stock owned by the officers of the company.

Q. Well, what percentage of the common stock do you own?

A. I own 10,933.95 out of a total of 29,833.5.

Q. Now, is the 29,833.5 issued and outstanding in 1943? A. Yes.

Q. How much does J. G. Gilfillan own? [326]

A. J. G. Gilfillan owns 1½ shares of common and 1400 shares of preferred.

Q. Is he a relative of yours?

(Testimony of S. W. Gilfillan.)

A. He is my brother.

Q. I. B. Sparks?

A. I. B. Sparks—in 1933 he owned 100——

Q. You mean 1943?

A. He owned 136.85 common, 2 preferred.

Q. A. J. Brown?

A. 79 common, none preferred.

Q. I Kemp?

A. 40 common, none preferred.

Q. J. H. Miles? A. J. H. Miles, none.

Q. I have named, have I not, all of the officers of the corporation? A. Yes.

Q. Who were the directors of your corporation in 1943? A. S. W. Gilfillan——

Q. That is yourself?

A. Yes. Edna Miles Gilfillan, that is my wife; J. G. Gilfillan, that is my brother; I. Kemp, she is the secretary and treasurer; Harvey Mudd, known here in Los Angeles quite well——

Q. Did you have a man by the name of McDermott employed [327] by you in the year 1943?

A. Yes.

Q. What was his position?

A. Purchasing agent of electronic parts.

Q. Did you have a man by the name of Forrest with you?

A. Jack Forrest, purchaser of other materials besides electronics.

Q. Did you have a man by the name of Howell?

A. Les Howell, contracting officer with military personnel.

(Testimony of S. W. Gilfillan.)

Q. A man by the name of Nevins?

A. Nevins, yes, personnel.

Q. Personnel. Miles, he was in charge of production?
A. Electronic production, yes.

Q. A man by the name of Ailsworth?

A. Yes.

Q. What was his position?

A. Oh, he was assistant buyer, I think, under McDermott.

Q. Brindley? A. Ross Brindley, yes.

Q. What did he do? A. In '43?

Q. Yes.

A. I wouldn't know. He is one of my old employees, been there for 25 or 30 years, and he didn't have an important [328] position around the plant there, and his salary was \$90.00 a week. I know that.

Q. Do you have any other brothers in your business besides the one that we have mentioned, J. G. Gilfillan?
A. No.

Q. That is your only brother?

A. That is my only brother.

Q. What did your brother do?

A. My brother in peace times took care of our foreign business. When the war effort came on, he pinch hit for anybody that wanted him to do any kind of a job.

Q. Did you have a man by the name of Lindsey?

A. Oh, yes.

Q. What did he do?

A. He is an electronic engineer.

(Testimony of S. W. Gilfillan.)

Q. Who were your top engineering men?

A. Homer Tasker, or chief engineer, and William Lindsey was assistant.

Q. How about Wolcott?

A. Fred Wolcott also was very—was a very good engineer.

Q. How about Myers?

A. Bill Myers, yes, he is an engineer.

Q. Was he considered a good engineer?

A. Yes. [329]

Q. Now, if I may go back and get some of the salaries of these men, if you can remember them, Mr. Gilfillan.

A. I will do the best I can, if that is satisfactory.

Q. McDermott?

A. McDermott in 1933—

Q. No, not 1933.

A. 1943. I keep saying '33 and mean '43. Oh, I really don't know what his was.

Q. Forrest?

A. Forrest, he would be getting the same as McDermott, and Howell would be getting the same, and I think it was at that time around \$125.00 a week.

Q. Nevins?

A. He would be around a hundred and ten a week.

Q. Lindsey?

A. Lindsey, \$12,000.00 a year.

Q. Wolcott?

(Testimony of S. W. Gilfillan.)

A. Wolcott, \$10,000.00 a year.

Q. Myers?

A. Bill Myers, \$125.00 a week.

Q. Do you have any other ten or twelve thousand engineers?

A. Yes, our chief engineer. He came to us from Paramount. He was chief engineer of Paramount, and we paid him \$15,000.00 a year; Homer Tasker. Now, I would like to [330] explain about those engineers. The Radiation Laboratory during the war had a development called GCA, ground control approach, and the Army and Navy use it completely as the only aid of getting planes down. We picked that up in the early part of 1942, and at the time we picked it up and proceeded to develop it further and to go into production and get them into the military hands during the war, we took over a group of engineers which Radiation Laboratory had called to their headquarters at M.T.I. there in Boston, and among them was Tasker. Now, Bill Lindsey was a very excellent physicist who was in the moving picture industry, and I am sure he came to us at a sacrifice of his salary.

Fred Wolcott came to us in '35 or '36 and developed a television receiver which we went on the market with before the war, and was a very capable engineer, and was well worth the money. That explains why that high bracket went in on those fellows, just take the engineers and make them.

Q. How many engineers would you say that you had in sum total, if you can approximate it, Mr. Gilfillan?

A. In the year '43?

(Testimony of S. W. Gilfillan.)

Q. Yes.

A. I would say that we started out in '42, engineers and technicians and draftsmen—laboratory, I take it you mean?

Q. Yes. [331]

A. The entire laboratory, well, probably 200.

Q. 200? A. That again is an estimate.

Q. Yes. Was Emandofer working for you in 1943? A. Yes.

Q. What was he doing in 1943?

A. He is just kind of a roustabout. He took care of our service. You see, our plant went into close secrecy prior to 1943, and we had certain obligations, to repair radios and refrigerators for customers on the outstanding, and we opened up a service department on Venice Boulevard on another premise to segregate the business from our secret work. Emandofer took charge of it. . .

Q. What had he done before that?

A. He came to us right after the first war, and he was a radio sales—first of all, he was an ignition parts salesman, then he was a radio salesman, then he was a man who contacted these manufacturers of radio chassis who couldn't get a license and we made their chassis for them. Among them was your Mission Bell outfit.

Q. When did he leave your employ?

A. I think about '44-'45, I imagine.

Q. Do you know what you were paying him when he left?

(Testimony of S. W. Gilfillan.)

A. Yes. I always tried to pay him well. He had been a good man and he was ill. We kept him for a year or two when [332] he was ill. Probably about \$500.00 a month.

Q. Did you ever prior to 1943 have any salesmen on an incentive basis?

A. Any salesmen—

Q. Do I make myself clear on that, on an incentive basis?

A. You are talking about commercial work?

Q. Yes.

A. Many times during the years we have been in business we have tried the incentive method and then we have tried the flat salary basis, and different periods of business—one works better than at another time. Yes.

Q. Well, back in 1926, '27 and '28, McNealy in Kansas City and McConnell in New York had such a plan, didn't they?

A. I think probably they did. They were managers of the branch plants I opened up back there.

Q. Do you remember what percentage you gave them on automotive radio set sales?

A. No, no. I would say that it was very little, because in '26 the company took a terrific loss and practically was broke and had to be rebuilt from that point, so their remuneration couldn't have been very heavy. Those two branches were closed.

Q. Do you have any incentive plans now on a distributor basis? A. Yes. [333]

Q. With a man by the name of Totten?

(Testimony of S. W. Gilfillan.)

A. Well, in 1943 Totten was a commander on a destroyer at sea. Are you talking about '43 or now?

Q. I was asking you then.

A. He was not in our employ in '43. He had never been employed by me until after he came back from the war and I gave him a job.

I might tell you about two other incentive plans, if you want to know about them that didn't work.

Q. Well, we have got such a wonderful one here that did, I don't believe I would like to hear discouraging plans.

A. Well, Mr. I. B. Sparks and Mr. Jennings Brown, vice-president, in 1941 had an incentive plan on the sales from the machine shop, and the war broke out. Their incentive pay would have gone up to \$50,000.00 a year, and both of them came to me voluntarily and asked me to put them on a straight salary of \$15,000.00 a year. That is the way those two incentive plans worked in our organization.

Q. But that was purely vountary on their part?

A. Yes, it sure was.

Q. Did you have any Washington representative?
A. No.

Q. You didn't have?

A. Well, you mean a hired representative?

Q. Yes. [334] A. No.

Q. Did you ever have anyone on a commission basis during the war?

A. On military orders?

(Testimony of S. W. Gilfillan.)

Q. Yes.

A. No, it was frowned down on by the government.

Q. Well, of course, you had a great many military orders before we declared war, didn't you?

A. Correct.

Q. So you probably didn't need anybody?

A. Only technical people to go around and pick them up.

Mr. Milliken: I think that is all, Mr. Crouter.

Mr. Crouter: Just two questions, if the Court please.

(Witness withdrawn.)

Whereupon,

S. W. GILFILLAN,

called as a witness for and on behalf of the Respondent, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination

By Mr. Crouter:

Q. Please tell the Court as best you can the approximate or average number of total employees of your corporation during the calendar year 1943.

A. In the early part of the year it was some place around seven hundred fifty. At the close of the year it was over a thousand.

Q. Now, referring to Exhibit G in evidence and your testimony regarding the figure of \$313,030.00 for general [335] and administrative expenses, please tell the Court what, if any, part of that fig-

(Testimony of S. W. Gilfillan.)

ure related to any business which was completed and sales completed after the day May 31, 1943.

The Witness: Will you read that again, please?

The Court: Read the question.

The Witness: Was that question correct? Was that after 1941? Is that the last part of that statement?

Mr. Crouter: That should be May 31, 1943.

Mr. Milliken: Now, if your Honor please, I object to that unless the witness has some specific data to qualify himself as to be able to break that down.

The Witness: I can't.

Mr. Milliken: That is satisfactory. I understood you to say you couldn't, Mr. Gilfillan?

The Witness: It would be just a horseback opinion. I haven't the figures here.

Mr. Milliken: Then I object to it.

The Court: The objection is sustained.

By Mr. Crouter:

Q. Referring to the figure up above that, the second line on Exhibit G, your cost of products sold, \$2,792,274.67. Did all of that relate to sales completed in 1943?

A. Yes, because that is the cost, the factory cost of the sales made.

Q. Did you have any cost figures which entered into [336] your fiscal year 1943 which really related to future business?

The Court: I am afraid that question if it is answered is not going to help you very much. What do you mean, ending May 31, 1943?

(Testimony of S. W. Gilfillan.)

Mr. Crouter: It may be confusing. I will withdraw that question, please.

By Mr. Crouter:

Q. Please tell the Court whether there were any factors in the operation of your business particularly during the seven remaining months of 1943 calendar year which really did not pay off and did not reflect itself in completed sales until after 1943.

A. The GCA development was picked up the early part, the middle of '42 and billing against that project because it was a development project, did not occur until after '43, although we spent \$2,000,000.00 during that period on administrative expenses, the cost of producing and engineering and so forth.

Q. About what was the overall consideration for that entire job?

A. That was—the development contract was \$2,100,000.00 approximately. The production amounted to \$12,000,000.00 roughly.

Q. What do you mean by “the production amounted to \$12,000,000.00 roughly”? [337]

A. Well, we developed 10 units and then built 50 for production to go into the field.

Q. That undertaking was in course then throughout the calendar year 1943? A. Yes.

Q. What in general was the basis of accounting of Gilfillan Brothers, a cash or accrual, your accounting system?

A. On a cash basis.

(Testimony of S. W. Gilfillan.)

Q. On a cash basis? A. Yes.

Mr. Crouter: That is all. Thank you.

Recross Examination

By Mr. Milliken:

Q. Mr. Gilfillan, are you sure you are on a cash basis?

A. Well, I should have asked for a definition of what cash basis is. By cash I mean that we—I think you got me there. I am kind of confused as to what is a cash basis. We pay our bills immediately and—well, I don't know. You got me, I will tell you right there.

Q. Well, I just assumed that you have a very substantial inventory at all times.

A. Yes, it fluctuates greatly.

Q. The Commissioner, I don't believe, would let anyone report on a large inventory— [338]

A. I will correct my statement. We are not on a cash basis.

Mr. Crouter: Do you happen to have a copy of one of your federal tax returns with you?

The Witness: No, I do not.

Mr. Crouter: No further questions.

By Mr. Milliken:

Q. Mr. Gilfillan, in that Exhibit G, of this \$313,-030.33, that was either all incurred or paid for the fiscal year ended May 31, 1943, wasn't it?

A. Yes.

Q. Either incurred or paid? A. Yes.

Mr. Milliken: That is all.

(Testimony of S. W. Gilfillan.)

The Court: Let me ask you one question, Mr. Witness. As I remember it, you said that some certain part of your business in 1943 was the production, commercial production of radios, was that right?

The Witness: No, it was in '42, Judge. In '42, the early part of '42 we made radios.

The Court: About when did that stop?

The Witness: About March or April.

The Court: Do you have any engineer in complete charge of that, that is, did you have any one engineer who was in charge of radio engineering?

The Witness: In '43?

The Court: No, in '42.

The Witness: In '42——

The Court: While you were producing radios?

The Witness: Yes, Fred Wolcott.

The Court: How many assistants did he have?

The Witness: Oh, he had about two or three.

The Court: What did you pay him, if you remember?

The Witness: \$10,000.00 a year.

The Court: That is all I wanted to know.

Mr. Crouter: May I ask one further question, if your Honor please?

Would the \$10,000.00 be for Mr. Wolcott and for each assistant, or was there a difference?

The Witness: I am giving you my recollection from memory. I believe that his remuneration was \$10,000.00 per annum in '42.

(Testimony of S. W. Gilfillan.)

Mr. Crouter: Now, with respect to the assistants, would they have about the same amount or would that be——

The Witness: Oh, they would drop down all the way from \$45.00 a week to \$125.00 a week.

Mr. Crouter: That is all.

Mr. Milliken: Just one question I would like to ask you Mr. Gilfillan. Were you aware of the work that the Hoffman Radio Corporation did during the year 1943, the [340] character of the work?

The Witness: No.

Mr. Milliken: You didn't know a thing about their contracts?

The Witness: No.

Mr. Milliken: Didn't know what type of contracts they had?

The Witness: I had heard they were doing electronic work.

Mr. Milliken: But I say you didn't know it?

The Witness: No.

Mr. Milliken: That is all.

The Court: You are excused.

(Witness excused.)

The Court: Call your next witness.

Mr. Crouter: That is all. Respondent rests.

The Court: Respondent rests, what says the Petitioner?

Mr. Milliken: Petitioner rests.

The Court: Now, you have a considerable record here. Until February 2, 1948 for both sides to file briefs. Until March 1, 1948 for reply briefs.

Mr. Crouter: Thank you.

Mr. Milliken: Thank you.

The Court: You have an interesting question here. [341] I would like to have briefs.

Mr. Milliken: We will do our best.

(Whereupon, at 3:25 o'clock p. m., Friday, December 12, 1947, the hearing in the above-entitled matter was closed.)

[Endorsed]: Filed Dec. 30, 1947.

PETITIONER'S EXHIBIT No. 1

July 27, 1943

SUPPORTING SCHEDULE No. 2

1. 1940, none; 1941, none; 1942, 35%.

2. H. L. Hoffman, Percentage Common, 50%; Percentage Preferred, 10%. G. G. Davidge, Percentage Common, 25%; Percentage Preferred, 24%. W. D. Douglas II, Percentage Common, 25%; Percentage Preferred, 66%.

3. The company has no affiliated or subsidiary companies. However, the company has taken a very active interest in establishing new vendors of component parts. This action was taken to relieve the strain on eastern vendors and guarantee a flow of material from local sources.

The company has been very active in analyzing and utilizing available manpower and equipment, rather than expand its own capital equipment. This necessitated very close supervision on the part of the company's management. That was effective in creating productive subcontractors on critical materials, such as—crystals, steo-tite molding, die casting, plastic molding and fabricating, fasteners, screw machine and sheet metal work. The company has no financial connection with any of these subcontractors.

The best example of the effectiveness of this policy is—that the present Frequency Meters we are building for the Navy we are handling 90% of our procurement here on the coast.

4. Mission Bell Radio Manufacturing Company,

Petitioner's Exhibit No. 1—(Continued)

Inc. was incorporated in 1932 as a California corporation for the purpose of manufacturing radio receiving sets. The company was originally owned by two stockholders, Mr. P. L. Fleming and Mr. H. G. Schmeiter. Distribution was through jobbers, dealers and private-brand users, such as—Sears, Roebuck & Company, Firestone Tire & Rubber Company, etc.

The company concentrated on low-priced units and were the first to market a small table model radio on the coast.

On October—1935—they purchased the Franklin Radio Company, whose main asset was a R.C.A. License to manufacture radio receivers. This license was one of three on the coast. All other manufacturers were licensed through Gilfillan Bros.

In 1940 the controlling interest of the company was sold to Franklin Warner with the understanding that additional capital would be supplied for manufacturing purposes. Mr. Warner failed to supply the additional capital and it developed that his scheme was entirely a stock promotion program, which did not materialize. Mr. Fleming and Mr. Schmeiter were unaware of this plan and they sold the controlling interest of the company and were unable to do any reorganization until November—1941—at which time the control came back into their hands.

At this time Mr. H. L. Hoffman and associates consummated a contract which gave them the entire stock of the company. Additional capital was added,

Petitioner's Exhibit No. 1—(Continued)

the Accounts Payable cleared and manufacturing reinstated.

It was the purpose of Mr. Hoffman and his associates to utilize the R.C.A. License and manufacture radio receiving sets, radio phonograph combinations and special equipment for the various Police Departments.

At the time Mr. Hoffman and his associates took over the company they had no engineers and no factory workers. The entire personnel consisted of a shipping clerk and a telephone girl. The main asset of the company was the R.C.A. License and one of the stipulations of the license was that it could not be sold or transferred. . . . Consequently it was necessary to rehabilitate the old company.

The first step in this rehabilitation program was to secure competent engineering and a small group of factory technicians. This was accomplished by the purchase of the Mitchell-Hughes Company, who had been very successful in the manufacture and distribution of a high quality, high priced, custom made, radio phonograph combination. Mr. Alex Hirsch, the owner of this company, had recently passed away and his heirs wished to liquidate the company.

The Mission Bell Company was fortunate in securing the services of Mr. W. S. Harmon as Chief Engineer and a group of twenty to twenty-five factory technicians, trained in the construction of high-quality merchandise. Mr. Harmon had for-

Petitioner's Exhibit No. 1—(Continued)

merly been with Mission Bell but had left at the time control was sold to Mr. Warner, due to the fact that he would have no connection with the program Mr. Warner had in mind. Before his connection with Mission Bell he had been the Chief Engineer of the Emerson Radio Company in New York.

Shortly after the Mission Bell Company had been purchased its main asset—namely a R.C.A. License—became valueless, due to the declaration of war and the waiving of all license arrangements for the services, and, also, by a W.P.B. ruling stopping the manufacture of home receivers as of April 22, 1942.

Plans were immediately initiated to complete the construction of materials on hand at Mitchell-Hughes and secure orders for immediate production of Mission Bell sets. This was done and then the company moved the Mission Bell operation into the Mitchell-Hughes plant and the two consolidated. All of this was necessary to complete the operation for the deadline of April 22, 1942. At the same time the program was initiated to solicit subcontract work for the war production.

The description of the conversion from peacetime production to war manufacturing is covered in Paragraph 5.

5. As outlined above the principle items of peacetime production were radio receiving sets, radio phonograph combination and special intercommunicating and shortwave receivers.

Petitioner's Exhibit No. 1—(Continued)

Due to the fact that the company was new and untried, it was decided that they would start out doing subcontract work, consisting of fabricating of radio components. This afforded two opportunities—one to prove to the various services that we could fabricate as well as assemble and secondly, to train the new organization in the mechanics and requirements of war communication equipment production.

The first order secured was from Bendix Aviation of North Hollywood for Variable Condensers. The company had never built Variable Condensers before; in fact, to our knowledge they had never been built on the coast before. Negotiations with Bendix Aviation was started in February, 1942, and sample completed within a period of three weeks. There was one other local company who submitted a sample, but our sample was much superior in construction and quality as well as lower in price—consequently, we were given the business.

Tooling was instituted immediately and manufacturing processes studied carefully. It was found that due to the peculiar design of this unit that conventional production methods could not be used. Consequently, it was necessary to devise special methods of soldering the plates to the rotor and stator shaft. The method originated was very effective and was gradually improved, based on experience. Other special tooling was necessary and special assembly jigs constructed.

Petitioner's Exhibit No. 1—(Continued)

An order for these Variable Condensers was issued February 10, 1942, and first deliveries were made April 6—sixty days later. This included the construction of all dies and production tooling.

Due to the quality of the work done on the Variable Condenser and the quick action we gave Bendix, they presented to us the problem of manufacturing the M-357A Antenna Kite. This Kite when presented to us was in a very crude form and merely gave the general idea and type of unit they desired. Bendix was, also, contacting an eastern source for the possibility of their manufacturing this Kite for them and secured quotations from this eastern source—the James Heddon Company of Dowagiac, Michigan.

Based on our original sample submitted for this unit and the fact that our price was lower than the eastern source, we were given a contract to produce 100 of these units. This contract was given to us on a Wednesday and they wanted delivery the following Sunday. This request was met, although it involved all of the officers of the company as well as the employees working all night for three consecutive nights.

Production contract for 16,000 of these units was awarded to us April 30, 1942 and delivery started on May 16, 1942. It was necessary for the company to redesign this Kite for production purposes, and due to the fact that a Kite of this design had never been manufactured before, it was necessary to completely retool the plant. This involved work-

Petitioner's Exhibit No. 1—(Continued)

ing out a method to cut chrome moly tubing, special soldering attachments for fastening the fittings to the Kite, special sawing machinery and jigs and special assembly jigs and tools to assure uniformity and high quality.

Both of these jobs involved complete retooling and plant reorganization. Inasmuch as neither one of these items had been built before, it involved training our existing organization and supplementing it with more mechanical experience and ability. During this period of conversion the company added materially to its engineering and technical staff.

6. The price on item 1—the Variable Condenser for the SCR-578 was 50% of the price submitted by the Radio Condenser Corporation, and 25% lower than the local source—namely, Audio Products.

On item 2—the M-357A Antenna Kite—quotation was only submitted by one other company, an eastern source—James Heddon & Son—and their price was approximately 10% above the Mission Bell price.

Although the prices quoted when these contracts were consummated were based on an average labor rate of 60 cents per hour, the prices were not increased; even though labor rates went to an average of 77 cents per hour, an increase of approximately 25%. In addition to this overhead burden, to handle inspection, government reports, etc., our cost was considerably increased. During the course of both of these contracts there have been various

Petitioner's Exhibit No. 1—(Continued)

changes and re-work, and the company has avoided increasing the price in any case where they could avoid it.

Any price increases that have been installed have been based on cost of materials, only. As an example of this—Bendix originally furnished the materials on the Antenna Kite, which consisted of the cloth and the rods, and we furnished the fittings and the labor for the complete fabrication of the Kite. The price for our labor and parts was \$4.90. Bendix expressed a desire to have the Kite packed in a smaller space. The company worked out a design for breaking the Kite in the middle. This new design involved an increase in the amount of materials used and consequently, an increase in the cost of materials. This price was raised to \$5.58.

Bendix then asked the company to procure the material on the next contract, and the company merely added the cost of the material to the existing price to arrive at their quotation.

During the life of these contracts there have been some definite increases in cost of material. We attach letter sent to Bendix covering these increased costs on the Kite.

Stamping and screw machine work on the Variable Condenser have almost doubled in price on this contract, due to the increased cost of vendors' labor. This increased cost was not passed on to Bendix, but was absorbed by our company.

The company has saved critical materials by

Petitioner's Exhibit No. 1—(Continued)

redesign of the units. On the Variable Condensers brass parts were changed to steel, saving 20% of the total weight of the unit and avoiding a procurement bottleneck. Insulators on the Variable Condensers were changed from one material to another to avoid shortage of critical materials. A method was developed for fastening the reinforced sleeving on the rods with a pressed fit to eliminate soldering, thereby reducing the weight of the Kite and eliminate the use of 50-50 solder in this part of the operation.

A new source of tubing for this Kite was established. This tubing was .0008 wall chrome moly tubing and made of the most critical materials. The company uncovered a large stock of stainless steel tubing, which originally had been drawn for Coca Cola dispensers. This tubing was re-drawn for use on the Kite; thereby relieving a critical shortage of chrome moly tubing and utilizing discarded material.

Several improvements in design were originated by Mission Bell and approxed by Bendix and the Signal Corps. This included a design for fastening the cloth to the framework of the Kite in a more efficient manner and eliminating stainless steel staples. Several other items were recommended by the company, both as to construction and design.

In July, 1942, the Signal Corps established Kingston Products Corporation of Kokomo, Indiana, as a subcontractor under Bendix to fabricate the complete SCR-578. The Signal Corps indicated that

Petitioner's Exhibit No. 1—(Continued)

they wanted an independent source for the Kite, due to a basic policy of not using common, component part sources. Mission Bell furnished Kingston with their original requirements and then sent complete blue print instructions and parts to James Heddon & Son, and instructed them on the construction of the Kite so that they could furnish Kingston with their requirements. Since that time we have kept Heddon advised on all improvements, and have given them the benefit of all the results we have obtained.

On June 30, 1942, the company entered into a Development Contract with Wright Field to develop a 28 volt Interphone Amplifier. This Development Contract was completed within 45 days. According to Wright Field it was the only Development Contract they knew of that was completed on time.

During the latter part of 1942 the company and accepted by Wright Field.

During the latter part of 1942 the company developed a Noise Silencer and presented it to the Army and the Navy. This development was accepted by the Navy with the advice that it would be installed in all subsequent receiver productions. However, the company waived all royalty rights.

In September, 1942, the company secured a contract to manufacture A-62 Phantom Antennas, and in November, 1942, secured a contract to manufacture A-58 Phantom Antennas. Both of these contracts were Prime Contracts through the Philadelphia Signal Corps. Delivery on both contracts have

Petitioner's Exhibit No. 1—(Continued)

been either up to requirements or ahead of requirements.

7. In December, 1942, our company made application with the California Bank, Los Angeles, for a \$200,000.00 Title V Loan. Our borrowing under that loan has not exceeded \$125,000.00. That loan has now been replaced with a new Title V Loan for \$400,000.00. The additional funds are necessary in connection with the financing of our Navy Contract, which has been in the engineering stages to date, but which is now going into production. It is our belief that this loan will adequately handle any financing necessary in connection with our present war orders.

8. Our present offices and principle manufacturing plant is at 3430 South Hill Street, Los Angeles, California. This property is leased from the Lloyd Corporation for \$300.00 per month. The lease expires July 1, 1945. We, also, have under lease the building at 3446 South Hill Street from Gertrude C. Bowers at \$90.00 per month. This lease expires July 1, 1945.

During the past month the company acquired property at 3751 South Hill Street for the expansion of its manufacturing facilities. The building contains 18,500 square feet and in addition a surface parking lot of similar area. This is a brick, one-story building, less than two years old, containing adequate wiring and other facilities for use in manufacturing at once. This building was appraised by the California Bank before purchase

Petitioner's Exhibit No. 1—(Continued)

was made and it was their thought that the building was not over priced.

An application for a Certificate of Necessity, covering equipment in the amount of \$4,459.15 was filed by this company on April 19, 1943. It is our intention to file a new application for a Certificate of Necessity in connection with our building purchase, which is entirely for war work.

9. The number of productive employees at the beginning of 1942 was 7—at the close of the year 94. At the close of 1942, 22% of the employees were male and 78% were female; 16% were skilled and 84% were unskilled.

10. Mr. H. L. Hoffman received \$18,699.52 for his services for the year of 1942 under his employment contract, dated December 4, 1941.

Mr. W. S. Harmon received \$7,244.18 for his services for the year of 1942 under his employment contract, dated March 10, 1942.

Mr. Hoffman's title is President and Mr. Harmon's is Vice-President in charge of Engineering.

11. Same as in Paragraph 10.

12. Captain Asbury—San Francisco Signal Corps. Captain Huff—San Francisco Signal Corps—Los Angeles area. Captain J. A. Biggs—A.R.L.—Wright Field. Captain Hill—Philadelphia Signal Corps. Captain Temple—Philadelphia Signal Corps.

PETITIONER'S EXHIBIT No. 2

Hoffman Radio Corporation
3430 South Hill St., Los Angeles, California

1943 REPORT

July 22, 1944

Signal Corps Price Adjustment Section
370 North Camden Drive, Beverly Hills, Calif.

Gentlemen:

We have previously given you the history, the background of the company, and the activities during 1942 of the Mission Bell Radio Manufacturing Company, Inc. As of November 12, 1943, the Articles of Incorporation of the Mission Bell Radio Manufacturing Company, Inc. were amended, changing the name of the company to the Hoffman Radio Corporation.

We now wish to bring our report up to date and cover our contribution to the war effort during 1943 and to make certain comparisons with our contributions for 1942 as follows:

	1942		1943	
1. Net Sales	\$230,136.00	100%	\$1,836,432.00	100%
2. Cost of Sales.....	171,643.00	74.5	1,489,033.44	81
4. Selling and Adver- tising Expense	2,444.00	01.1	6,872.38	00.4
5. General and Admin- istrative Expense	20,492.00	08.9	116,861.75	06.3
			[Penciled]: 30% reduction	
6. Net Operating Profit	35,557.00	15.5	223,665.42	12.17
8. Other Applicable Deductible Items	2,030.00	00.9	11,808.26	00.64
	<hr/>	<hr/>	<hr/>	<hr/>
Net.....	\$ 33,527.00	14.6	\$ 211,857.16	11.53
			[Penciled]: 21% reduction	

Petitioner's Exhibit No. 2—(Continued)

While these figures show that we have increased the production of war goods more than seven times, still it does not give a complete picture.

We were asked during the past year to produce items many times more complex than those which we produced in 1942. We have also been asked to assist in the development of new equipment. Some of this newly developed equipment is now in use and other items are now being manufactured. The importance of these items is much greater to the war effort than what we were producing during 1942. Endeavor will be made to explain that point more fully later in this report.

Delivery Record—Our company, during 1943, had a record of delivering all of its materials either ahead of time or in accordance with production requirements. There was only one record of not meeting the delivery requirement specified in our contracts, and that was where our company was building the same equipment for two different procurement districts. The inspector-in-charge modified shipping instructions to the point where the final completion of one order was not until forty-five days after the specified delivery date. This was accomplished in spite of manufacturing delays beyond our control, such as the diverting by the War Production Board of stainless steel tubing to other war contracts and the failure on the part of some suppliers to meet production specifications.

Prices—The prices which we have charged for equipment furnished to the Services in 1943 have

Petitioner's Exhibit No. 2—(Continued)

been conservatively below those of other contractors, or they have been competitive.

During the year, we continued to supply variable condensers, and we were the only source of supply for this particular item. Our prices remained the same in spite of rising material and labor costs.

We are the largest manufacturer of antenna kites, and we have made a material reduction in the unit price during the year and we expect to make further reductions during 1944.

It is our understanding that our prices on the A-58 phantom antenna and the A-62 phantom antenna which we manufactured for the Signal Corps were competitive. We also made a contract price reduction of \$8,540.00 on our A-62 contract.

On our frequency meter contract, we were given a price of 10% over existing prices to allow for tooling amortization, and on the basis of the prices allowed, we have already made price reductions and a cash refund totaling \$656,327.50. It is anticipated we will make at least another \$150,000.00 cash refund on the original contract of \$4,000,000.00.

The actual cash refunds made on 1943 business were \$8,540.00 on our A-62 contract and \$100,600.00 on our frequency meter contract or a total of \$109,140.00. This sum is 51.5% of our net profits for the year 1943.

Substitution and Economy in the Use of Materials—Our Engineering Staff has been able to overcome a number of critical situations by working

Petitioner's Exhibit No. 2—(Continued)

out substitutions of raw materials and by changing component parts. Approval was obtained on all recommendations submitted.

In the building of A-58 phantom antenna, request was made and permission given to use cold rolled steel instead of aluminum for the case and front panel, thereby saving approximately 20,000 pounds of aluminum which at that time was a critical item.

Substitution was made and approval received for the use of cold rolled steel for the base and end plate of the variable condenser, thus eliminating a corresponding amount of copper.

In building frequency meters, we made numerous substitutions of materials and component parts and in the methods of production. Many of these substitutions enabled us to get into production sooner on this vital equipment, and all of the changes have been officially approved. Some of the more important of these are as follows:

1. The variable condenser plates were zinc plated with Iridite instead of silver to improve the salt spray resistance.

2. The front panel of the unit has been made separate from the chassis. This has saved the scrapping of many engraved panels where the chassis was rejected or had to be re-worked.

3. Caustic dip was substituted for sand blasting and lacquer which saved time and considerable expense.

Petitioner's Exhibit No. 2—(Continued)

4. To overcome a procurement bottleneck, a Vinylite cable was substituted for rubber cable.

5. Permission was given us to substitute a pilot light for a meter when the latter became difficult to secure.

6. We submitted a plan for the use of extrusions in place of inserts in the chassis which has saved much loss of time in assembly as the inserts frequently came out and also saved cost on screw machine parts.

7. One of the biggest improvements over previously used methods was in substituting a plated crystal instead of the air gap type crystal. This substitution has greatly improved the stability of the unit.

8. We have developed a new construction for hermetically sealed transformers and reactors and have instructed a local source in the production of these items.

Reasonableness of Costs and Profits—The peacetime operation of our company is that of radio assembly. It was the practice of the old company to purchase component parts and to assemble them into complete radio units. This did not involve complicated procedure and only required a minimum of equipment. The testing procedure was also relatively simple. When conversion was made over to war work, the first items produced were not complicated. We manufactured these items as a sub-contractor. When we became prime contractors, the items manufactured became more complex.

Petitioner's Exhibit No. 2—(Continued)

Their importance to the war effort also increased.

From relatively simple items, we now manufactured equipment that has 588 parts, 211 assembly operations and 16 electrical tests. This whole procedure is entirely different from normal peacetime work and requires a greater skill and a higher type of personnel. In most cases, we have trained the necessary personnel.

As production has increased, overall profit has been reduced. In 1942 the percentage of profit was 14.6 on renegotiable business. In 1943 this has been reduced to 11.5 percent.

Capital Employed—All war orders awarded to our company have been financed from company funds or from loans guaranteed by the stockholders of our company.

During 1942, in addition to the company capital and advances by the stockholders, it was necessary that financing be handled by bank loans endorsed by the stockholders of our company. For 1943, in addition to company funds and further advances by the stockholders, the financing of our orders was by Title "V" Loans.

The original loan of \$200,000.00 was made January 15, 1943 with the California Bank. That loan was fully guaranteed by the stockholders of our company. On July 10, 1943, we found it necessary to increase that loan to \$400,000.00 and this amount was again guaranteed by the stockholders.

Later in the year it appeared evident that we would require additional funds in order to handle

Petitioner's Exhibit No. 2—(Continued)

increased production requirements of frequency meters. Production was to be stepped up to where in April of 1944 we would be producing 1,200 units per month. On the basis of that production requirement, it was estimated that we would need a maximum of \$1,220,000.00.

This new Title "V" Loan was granted by the Bank of America National Trust and Savings Association inasmuch as it was in excess of the lending power of the California Bank. The stockholders again gave their personal guarantee to this loan for an amount of \$400,000.00. At no time has it been necessary that we borrow in excess of \$400,000.00.

Due to the transferring of the Disbursing Office from Washington, D. C. to San Diego, California, payments have been received much faster than was anticipated. There was also a reduction of the monthly requirement of frequency meters to 800 units a month. As a result of this, the present loan will handle all requirements under our present orders and orders which will start in the latter part of 1944.

When it became evident that additional facilities would be necessary for the manufacture of frequency meters and other items for which we had been advised the Navy was contemplating awarding contracts to us, property was purchased at 3751 South Hill Street. This property consists of a building with 18,500 square feet of manufacturing space with a parking lot of equal size.

Petitioner's Exhibit No. 2—(Continued)

The purchase price was \$55,000.00, and the purchase was made only after the California Bank appraised the property and considered the purchase price was under the physical valuation of today's market. The terms of the purchase were: Cash, \$25,000.00—Trust Deed, \$30,000.00. The \$25,000.00 down payment was advanced by the stockholders of our company. In return, they took corporate notes payable on demand. Subsequent to the purchase, application was made for a Certificate of Necessity in the amount of \$55,000.00 which was granted.

The above \$25,000.00 advanced by the owners of our company, together with previous advances, made a total of \$72,500.00. In order to increase the financial structure of our company, application was made for a permit to issue preferred stock for these officers' advances. That permission was granted, and this obligation was, on December 31, 1943, transferred from a current liability to a capital liability.

This year we are building an addition to our plant at 3751 South Hill Street. It involves a total investment of approximately \$15,000.00 including additional land and the building. This will be paid for by the company without making application for a Certificate of Necessity even though the rest of the property is covered by such a Certificate.

Extent of Risk Assumed—As explained under the previous heading, we expanded our facilities, using our own funds, in anticipation of the work

Petitioner's Exhibit No. 2—(Continued)

to be assigned us. The correctness of this procedure has been demonstrated by the fact that we have had the facilities available when the demands were made on us.

All of our contracts for war equipment have been on a fixed price basis. It has been the company policy to fix a price based on an estimate of material, labor and overhead costs together with a reasonable profit, and if the estimate proves too high, to make price reductions.

In taking on the contract to build frequency meters for the Navy, we definitely assumed obligations which, if we had not been able to meet, would have resulted in the stockholders being liable under their personal guarantee. Two companies had previously failed in attempting to build this equipment.

In the building of frequency meters, we operated under a Letter of Intent until such time as we were in a position to handle complete units. A Letter of Intent provides that in the event of failure to deliver or to meet requirements, the Government can reimburse for actual expenditures and assume title to all materials from that point on. Any cancellation of operation would have meant that the corporation would have been refunded the actual costs with no compensation for the time spent on the project.

Contribution to the War Effort—In 1943 we entered into an arrangement with the E. J. Hall Electrical Laboratory, whereby our company was to engineer for production and to market an elec-

Petitioner's Exhibit No. 2—(Continued)

tronic relay and noise peak limiter. These items accomplished certain desired results in eliminating noise from sending and receiving equipment.

The engineering work was completed and working models were sent to Washington with representatives for presentation of the equipment. The effectiveness of the equipment was demonstrated and resulted in orders from the Federal Communication Commission, the Treasury Department for use by the Federal Bureau of Investigation and the Office of Strategic Service.

Based on the results of the equipments delivered, we have been given a development contract for the adaptation of the electronic relay for use by the Navy in connection with certain types of sending and receiving equipment. Our engineers are also continuing to cooperate very closely with the Navy Department on certain noise problems which they are endeavoring to eliminate.

We have received orders from the Navy for the noise peak limiter built as a separate unit. Permission has been given the Navy and schematic diagrams of the noise peak limiter made available so that this limiter could be built into communication equipment being manufactured by other concerns. Under instructions from the Navy, other concerns building Navy equipment are incorporating this feature.

Our company was selected by the Office of Scientific Research and Development to cooperate with the California Institute of Technology and engineer

Petitioner's Exhibit No. 2—(Continued)

for production the firing error indicating equipment which had been developed by the California Institute of Technology. Our best engineers were assigned to this project, and we had from three to five engineers working on this during the last seven months of 1943.

This development work has been continued in 1944. The equipment designed has now been accepted, and 2,000 transmitters and twenty-three power supplies and receivers are being built for the Office of Scientific Research and Development. This is new equipment, and the entire production is being handled as a development contract without profit to us.

A number of developments and improvements have been made in the manufacture of antenna kites, and all of the improvements have been made available to the other contractor making this same equipment—James Heddons Sons of Dowagiac, Michigan. These improvements include a new split kite design, a new cloth clamp, and the grooving of the hinge clamp for greater rigidity. Now our engineers are about to eliminate the soldering operation which should greatly speed up production of this equipment. At the request of the Instrument Division of the Weather Bureau, we have constructed a three-section kite which has been submitted to them for tests.

Our company has also built and carried on experimentation with various other kite designs at the request of the Navy Department, and these

Petitioner's Exhibit No. 2—(Continued)

have been demonstrated to the Navy at San Diego, some of the equipment built being of a confidential nature.

In the manufacture of frequency meters for the Navy Department, we have cooperated with the other supplier, Bendix Radio of Towson, Maryland, supplying them with drawings of all changes of design and substitutions which have been developed by our Engineering and Production Departments. All the items listed elsewhere covering improvements in the frequency meter and changes in the methods of manufacture have been made available to Bendix Radio.

The developments which have been made by our Engineering and Production Staffs in the frequency meter have resulted in a superior unit over that which was submitted to us as a sample. As a result of these improvements, our company has been selected as the only source for future production of C.F.I. Units for the Navy Department.

We, therefore, consider that our development and production of frequency meters to meet the close tolerances required and to produce such a superior unit that we would be selected to continue the production for the Navy on future orders in place of the previous supplier is our outstanding contribution to the war effort during 1943.

Character of Business and the Extent of Sub-Contracting—Upon entering into war work, we decided to limit activity, as much as possible, to production engineering and assembly. Following

Petitioner's Exhibit No. 2—(Continued)

that procedure, it was decided to utilize existing facilities in this territory and not establish new facilities in competition.

This plan of operation has necessitated the establishment of an Outside Production Department which has five employees at the present time. This Department has contracts with many of the smaller plants which can supply us with work in which they specialize such as screw machine parts, metal fabrication, coil winding, sheet metal, plating, plastics and similar work. The Outside Production men carefully check over the facilities of these plants before the order is placed, and then follow the work carefully to see that they keep production to the tolerances required and that delivery schedules are met.

This plan of utilizing existing facilities of other companies keeps down the investment in fixed assets, many of which could only have been supplied to us on a high priority.

In 1942 we sub-contracted approximately \$40,000.00 of business; in 1943 over \$500,000.00 or approximately 30% of the cost of sales. In most cases, we supplied the material, so that we were really purchasing labor and the use of facilities, thereby spreading out the war work to many small sub-contractors.

Other Factors—During the year 1943 we placed special emphasis on employee management relations. We have a semi-monthly meeting of employee representatives from each production line together

Petitioner's Exhibit No. 2—(Continued)

with representation from management. At these meetings plans for better working conditions are discussed and any problems which have arisen between the employees and management are settled.

We have a suggestion box, and this employee group makes awards for suggestions which they consider have merit in increasing production, working conditions or in connection with any other matter relating to plant efficiency. This arrangement has worked out very satisfactorily, and on an average ten awards for suggestions are made at each meeting.

Forty percent of the new ideas and improvement of manufacturing conditions in our plant have resulted from employee suggestions. Our employee management plan has given our employees a feeling that they have a part in the management of the company and that if they have a suggestion of any kind, it will be given proper consideration.

The dollar volume of production per employee was \$2,425.00 in 1942. In 1943 the dollar volume of production per employee was \$4,844.00.

This computation is made after deducting sub-contracted work and profits. While it is appreciated there are other factors than increased efficiency which would have contributed to this increased dollar volume, nevertheless, we consider a large part is due to the reason and the greater interest which our personnel now has in their work.

The restaurant facilities in the immediate neighborhood are not sufficient to meet our expanded

Petitioner's Exhibit No. 2—(Continued)

force, and it was, therefore, necessary that we establish our own commissary in order that our employees have warm wholesome meals. A complete meal is served at a cost of 40 cents.

Hot coffee and light refreshments are available to our employees during the ten minute rest period in the morning and in the afternoon.

This has been of material aid in maintaining employment and in reducing labor turn-over. Our average monthly labor turn-over for 1943 was only 11%. Further efforts to reduce absenteeism are summarized as follows:

1. Vitamin pills are furnished at cost to employees.

2. Oral cold vaccine has been supplied without cost.

3. A visiting nurse arrangement has been established for our plant and for home calls where requested, or where a person is absent for more than three days time. This system, originally installed by our company, has been copied by many other small plants in the Los Angeles area. See photostatic copy of letter attached.

4. A vacation policy has been established to give one week vacation with pay to all employees who have been with the company for one year. Each employee is entitled also to an additional half-day for each month's perfect attendance. An employee with perfect attendance for the year thereby gets two full weeks vacation with pay. Many factory employees have qualified for the full two weeks.

Petitioner's Exhibit No. 2—(Continued)

5. Group insurance has been made available to employees, the company assuming one-quarter of the premium and the employee three-quarters.

6. Three times a year service pins are awarded our employees for commendable attendance. For four months service with a maximum of two days absence, a sterling silver pin is given. A eight month pin is awarded for service for this period with not more than four days absence. Employees are eligible for a gold service pin after twelve months of service with an accumulated absence of not more than six days. The interest in obtaining these pins we feel has materially reduced absenteeism. Our absenteeism is approximately 3.5%.

We have attempted in this letter in general terms to set forth our increased contribution in 1943 to the war effort. Some of the outstanding facts we have set forth in the graphs attached.

1. Graph E indicates our sales volume increased 689% while plant facilities (Graph A) only increased 167%, showing a greater utilization of our factory space. Graph F shows that in expanding our war production we only expanded our personnel 177%.

2. Graph B indicates the greater distribution on our part of our contracts to smaller shops. Graph C shows relation of our various contracts with reference to the number of parts sub-contracted, production of which it is necessary for us to supervise in the various sub-contractors' plants.

3. Graph D indicates the greater complexity of

Petitioner's Exhibit No. 2—(Continued)

our frequency meter contract, our principal contribution to the war effort in 1943, as compared with the previous prime contracts assigned to us. In addition to the increased number of parts for our frequency meter contract, a much closer tolerance is required and a higher skilled personnel is necessary to handle these parts. It is the complex nature of this contract that has required the expansion of our Engineering Department as is indicated by Graph G.

4. Graph H indicates that our hourly labor rate has increased 36%. In making this increase, we have not increased our selling prices. This increase is due to a higher labor rate range granted us by the National War Labor Board and by the employment of specialized labor on the more complicated work on the frequency meter. All the people employed on the premium paying jobs are trained in our plant.

We are also attaching a brief summary of each different item we have manufactured and the pertinent facts regarding the various contracts under which we have operated.

We might briefly summarize our comparison of our 1942 and 1943 contributions by a statement that in 1942 we were acting as sub-contractors. In 1943, based on our records as a sub-contractor, we were made prime contractors and assigned equipment to build which up to that time had only been manufactured by one other source for the Navy.

We feel we have met the obligations imposed

Petitioner's Exhibit No. 2—(Continued)

upon us as a prime contractor by having met delivery schedules, produced on a competitive price basis and delivered a product superior in many respects to that delivered by other contractors.

We feel these statements are justified by the fact that we have again been assigned a more difficult contract for the building of equipment which is of a confidential nature.

This report is respectfully submitted as an addition to that already in your files.

Very truly yours,

HOFFMAN RADIO CORP.,
H. L. HOFFMAN,
President.

HLH:ea

Department of Health
City of Los Angeles 12
George M. Uhl, M.D., M.S.P.H.
Health Officer

May 1, 1944

Mr. H. L. Hoffman
Hoffman Radio Company
3430 South Hill Street
Los Angeles 7, California

Dear Mr. Hoffman:

The Division of Industrial Hygiene would like to take this opportunity to commend you for the efforts you have made in the interests of improving the conditions relating to the health of your employees.

Petitioner's Exhibit No. 2—(Continued)

Since our first study in your plant in July, 1942, you have faithfully followed all of our recommendations for the control of toxic exposures and unhealthy working conditions. You have called us in for engineering evaluations whenever you have instituted a new process, in addition to having us make repeat tests on permanent equipment. Also, your industrial nursing set-up has been a model for other medium-sized plants and has shown that a practical and useful arrangement for providing medical services can be made by such plants.

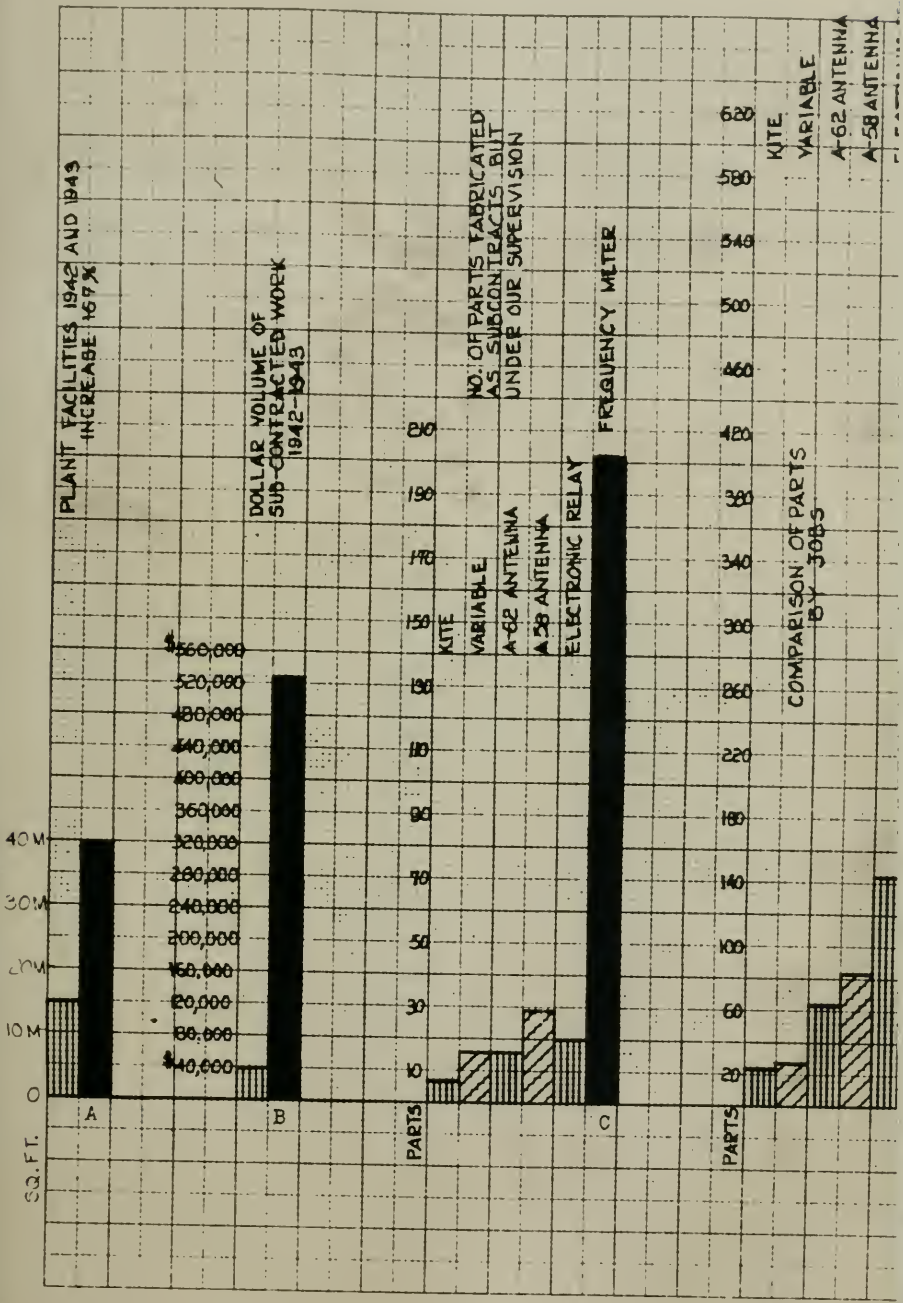
Whenever we can be of further service in evaluating your industrial health problems, engineering or medical, please do not hesitate to call upon us.

Sincerely yours,

/s/ FRANCIS E. BALLARD, M.D.,
Director, Division of Industrial Hygiene.

FEB:eb

10 to the half inch, 1/8 inch interval
Engineering 1-18-43
S. J. S. S.





GROSS SALES, COMPARISON
ON WAR ORDERS 1942-1943

\$2,000,000
1,800,000
1,600,000
1,400,000
1,200,000
1,000,000
800,000
600,000
400,000
200,000

1942



1943



NUMBER OF EMPLOYEES
DEC. 31, 1942 AND 1943
INCREASE 177%

300
260
220
180
140
100
60
20

1942



1943



ENGINEERING STAFF
DEC. 31, 1942 AND 1943

35
32
28
24
20
16
12
8
4

1942



1943



HOURLY RATE INCREASE -
AS OF DEC. 31, 1942 AND DEC. 31, 1943.
INCREASE 56% FOR FACTORY LABOR.

60
55
50
45
40
35
30
25
20
15
10

1942



1943



Petitioner's Exhibit No. 2—(Continued)

A material reduction in plating costs can be made if this should be adapted.

The relation of our variable condenser production as to the number of parts and amounts subcontracted is referred to in Graphs C and D.

ANTENNA KITES

Year	Production in Units
1942	20,457
1943	38,407

Production Schedule—Production of antenna kites varied from 2,000 to 5,000 per month. We experienced considerable delay in production due to the diverting of stainless steel tubing to the aircraft industry. In spite of that, we have been able to keep six months ahead of Bendix Aviation, Ltd. requirements.

To maintain our production schedule, we were required to have nearly half of our shipments of stainless steel and chromoly tubing sent in by air express. In addition to that, we spent many hundreds of dollars in long distance calls and telegrams to be able to even get the shipment by air express. This has materially increased our cost of production during 1943.

Prices:

1942: Where Bendix furnished material, \$5.58.

1942-43: Where we purchased all parts, \$9.79.

1943: Where we purchased all parts and packed in waterproof container, \$10.07.

Petitioner's Exhibit No. 2—(Continued)

1943: Kingston Products Order—no waterproof packing required; price based on use of 100% welded tubing, \$8.83.

1944: Dayton Signal Corps Procurement District Order—Price based on overseas packaging and use of part welded and part drawn tubing, \$9.20.

Improvements—Expediting of the drawn tubing cost us many hundreds of dollars during 1943. With the uncertainty of that source of supply, we started to assist a concern who had an idea of welding stainless steel sheets into tubing. After considerable experimenting and development, a welded tubing was developed which has been given Signal Corps approval for use in antenna kites. This new source of supply is materially aiding us in meeting the delivery schedule of the Dayton Signal Corps Procurement District.

The old system of stapling the cloth to a strip of tape run through a spring soldered to the longerons was abandoned after we obtained Signal Corps approval of the use of the new cloth clamp. This process is faster, the operators can work while sitting instead of standing, and we have gotten away from a critical material—monel staples—which were Signal Corps specifications.

We developed a method of swedging sleeves on kite rods to save solder and eliminate a costly soldering operation.

We put a special crimp in the kite cluster which gives it greater strength.

We standardized all the rivets in the kite by

Petitioner's Exhibit No. 2—(Continued)

VARIABLE CONDENSERS

Year	Production in Units
1942	30,754
1943	66,987

Production of the variable condensers more than doubled in 1943 over that of 1942. We are the source of supply for these condensers for both Bendix Aviation, Ltd. and Kingston Products Corp. Our production varied from 4,500 to 8,000 units per month, and we have been approximately six months ahead of manufacturing requirements.

Prices:

1942: Where Bendix paid for plating, \$2.22.

1942, 1943, 1944: Where we paid plating costs as well as supplied all parts. Additional cost to us of 75 cents, \$2.94.

The price of \$2.94 has been maintained in spite of increased material, labor and contracted work costs.

During 1943, to aid Marine Radio Manufacturing Company, we made a variation of our variable condenser to meet their requirements and to assist them in getting around a manufacturing bottleneck. We made 1,500 units for them at a price of \$3.85 each.

We have submitted to the Signal Corps a new process of plating called Iridite. We use this process on our Navy variable, and it stands the 200 hour salt water test better than the gold plating.

Petitioner's Exhibit No. 2—(Continued)

A material reduction in plating costs can be made if this should be adapted.

The relation of our variable condenser production as to the number of parts and amounts subcontracted is referred to in Graphs C and D.

ANTENNA KITES

Year	Production in Units
1942	20,457
1943	38,407

Production Schedule—Production of antenna kites varied from 2,000 to 5,000 per month. We experienced considerable delay in production due to the diverting of stainless steel tubing to the aircraft industry. In spite of that, we have been able to keep six months ahead of Bendix Aviation, Ltd. requirements.

To maintain our production schedule, we were required to have nearly half of our shipments of stainless steel and chromoly tubing sent in by air express. In addition to that, we spent many hundreds of dollars in long distance calls and telegrams to be able to even get the shipment by air express. This has materially increased our cost of production during 1943.

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Petitioner's Exhibit No. 2—(Continued)

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Improvements—Expediting of the drawn tubing cost us many hundreds of dollars during 1943. With the uncertainty of that source of supply, we started to assist a concern who had an idea of welding stainless steel sheets into tubing. After considerable experimenting and development, a welded tubing was developed which has been given Signal Corps approval for use in antenna kites. This new source of supply is materially aiding us in meeting the delivery schedule of the Dayton Signal Corps Procurement District.

The old system of stapling the cloth to a strip of tape run through a spring soldered to the longerons was abandoned after we obtained Signal Corps approval of the use of the new cloth clamp. This process is faster, the operators can work while sitting instead of standing, and we have gotten away from a critical material—monel staples—which were Signal Corps specifications.

We developed a method of swedging sleeves on kite rods to save solder and eliminate a costly soldering operation.

We put a special crimp in the kite cluster which gives it greater strength.

We standardized all the rivets in the kite by

Petitioner's Exhibit No. 2—(Continued)

using the same rivet in hinge clamps as in the cluster. This change added strength to the assembly and simplified procurement by reducing the number of riveting machines needed for production.

We have been asked by the Navy Department to do certain development work on kites. This involved different designs for greater lifting power and experimentation in radar use. Several models have been submitted to the San Diego Base for further test.

The relation of our antenna kite production as to the number of parts and amounts sub-contracted is referred to in Graphs C and D.

A-62 PHANTOM ANTENNA

1943: Units Produced, 20,114.

Production was scheduled from February to November, 1943. Our shipments averaged more than 1,000 units per month over production schedules until in August. At that time, the failure of the Clarostat Corporation to deliver acceptable resistors forced a suspension of our production line for practically sixty days. In spite of that delay, we were able to complete our production on schedule.

Price—Our bid price was \$11.75 per unit which was 50 cents per unit under the concern who was given sixty percent of the contract and who were tooled for the job. On the last 854 units, we made

Petitioner's Exhibit No. 2—(Continued)

a reduction of price of \$10.00 per unit, making the price \$1.76. This affected a total contract price reduction of \$8,540.00, and reduced the overall unit price to \$11.52.

This contract was our first as a prime contractor and represented a considerable increase in manufacturing complexity over previous items. There were 62 separate items as compared with 26 on the variable condenser. Each item had to pass certain electrical and mechanical tests, all of which were supervised by an engineer.

We worked out a process of knurling the cap which saved considerable time and cost over previous method of fabrication. We made this a punch press instead of a screw machine operation.

The relation of our A-62 production as to the number of parts and amounts sub-contracted is referred to in Graphs C and D.

A-58 PHANTOM ANTENNA

1943: Contract W-2124-sc-7183—Order No. 13547 Phila 43—4697 Units at \$38.14 each.

1943: Contract R-9409—Order No. 24218 Phila 43, 39 Units at \$40.38 each.

1943: Contract W-2124-sc-1789—File 11751-WF-43, 1118 Units at \$39.88 each.

Production was scheduled on the three orders from January to July of 1943. On the first con-

Petitioner's Exhibit No. 2—(Continued)

tract, we completed delivery in June while the required schedule ran until July. On the second contract, we delivered in May, the month delivery was requested. On the third contract, we delivered 700 in the month requested and the balance during the following forty-five days.

Deliveries on the three contracts were regulated by the local Signal Corps office. All of the third order could have been delivered on schedule, and we would still have completed the first order by the final delivery date. We, therefore, consider delivery schedules were met.

We established our own source of supply on the West Coast for the steatite parts and supervised their production.

We also obtained from the Signal Corps permission to substitute cold rolled steel for aluminum in the case, thereby saving approximately 20,000 pounds of this scarce material.

The relation of our A-58 production as to the number of parts and amounts sub-contracted is referred to in Graphs C and D.

FREQUENCY METER

This is one of the Navy's most complicated precision electronic equipments. Several companies have tried building this equipment unsuccessfully. The Navy had only one source of supply, and they were anxious to establish another to insure deliver-

Petitioner's Exhibit No. 2—(Continued)

ies of this vital equipment and also to expand the delivery schedule.

Accordingly, a Letter of Intent NXss-19076 was awarded to us on December 5, 1942, for the building of frequency meters. This Letter of Intent, now reduced to a fixed price contract, has been amended increasing the amounts as follows:

	Units	Dollar Value
December 5, 1942.....	4104	\$1,561,535.00
July 9, 1943.....	2363	498,750.00
September 30, 1943.....	725	1,504,330.00
November 12, 1943.....	1250	473,125.00
	8975	\$4,037,740.00

Average price, including spare parts—\$461.44.

After being awarded the contract, we first secured permission from Bendix Radio of Towson, Maryland, the other manufacturer of frequency meters for the Navy, to send some of our key men to their plant to study their production methods. These engineers were given every cooperation by the Bendix Radio Engineering Staff.

Next, we started tooling, building test equipment and working out procedures. As an indication of the work involved, there was approximately \$100,000.00 of test equipment and tooling necessary before we could start production. Much of this equipment was built right in our own laboratories. We completed the preliminary work and were in

Petitioner's Exhibit No. 2—(Continued)

production approximately six months after starting which was about half the time required on any similar tooling operation.

This equipment, which consists of a basic C.F.I. unit, has four adaptations.

The first, which is the C.F.I. alone, is primarily for aircraft and is airborne.

The second is a basic C.F.I. plus a power supply. The primary use is in air stations, bases and ship and shore installations where 115 volt power supply is available.

The third, the LM-16, which is a basic C.F.I. placed in a water-tight carrying case, is for use on ship board and advanced bases. The watertight carrying case permits it to be floated ashore along with other gear.

The fourth, the LM-17, is a C.F.I. unit with metal carrying case containing batteries and spare parts. This is used where there is no available power supply such as advanced bases or outlying posts.

For this operation, it was first necessary to build up an engineering staff who was capable of handling this type of work. Then it was necessary to train foremen to handle the various assembly lines, and last it was necessary to train all of the personnel to handle the manufacturing and testing. In all, 167 employees were trained during the last six months of 1943 for this job.

Petitioner's Exhibit No. 2—(Continued)

The production requirements at the beginning of our contract were as follows:

	Aug.	Sept.	Oct.	Nov.	Dec.
Production Requirements	100	200	350	400	500
Actual Production	74	300	406	510	526
Over or Under	26*	100	56	110	26

* Figures in red.

From our production schedule as compared with the production requirements, we exceeded deliveries in every month of 1943 except the first month of production.

This equipment must be built to very close tolerances. It is necessary to compute 4,000 calibrations to .0001% accuracy for each unit at a temperature range from -30 degrees to +68 degrees Centigrade. It is necessary that we give every C.F.I. unit some sixteen electrical tests before they are ready for Navy acceptance.

Our Engineering Staff and production foremen have developed many improvements on this equipment, a partial list of which appears in our letter. Some other improvements are:

1. The substitution of "Rincote" for engraving on the front panel has saved time and cost.
2. Snubbing washers have been added to the C.F.I. shockmount which prolongs the life of the shockmount under violent vibration.
3. The cable routing in the power supply unit has been improved to save time and cable losses.
4. Slots have been added for cable grommets

Petitioner's Exhibit No. 2—(Continued)

in the power supply to save time and cable installation.

5. We have developed a short check for temperature runs which saves time and cost without decreasing accuracy.

6. The number of different types of rivets in the C.F.I. unit has been decreased to improve the assembly time.

7. Deviation meters instead of dial divisions are used for quick checks of stability, backlash, switches and drift to save testing time.

8. We have changed from steel to brass plates on the trimmers and correctors to improve salt spray resistance.

9. The tube-clamp assembly has been changed to improve stability.

10. The band switch collar has been changed to enable use of bathtub condensers from alternate manufacturers.

11. The wiring of the coil shelf has been changed to improve the stability and temperature coefficient and to decrease the chance of shorting.

12. A one-piece drum instead of two-piece is used to save cost and time.

To begin with, the variable condenser used in the C.F.I. was purchased complete from Rauland Manufacturing Company in Chicago. They were supplying the same item to Army contractors. As our production increased, it became evident that they could not meet our requirements. We, therefore, tooled up to build this variable and are now producing our entire supply.

Petitioner's Exhibit No. 2—(Continued)

The company, on January 25, 1944, after having some manufacturing experience, found that they could amortize the required facilities over the present contract and still reduce the dollar value of Contract NXss-19076 from \$4,037,744.00 to \$3,381,417.00, or a price reduction of \$656,327.50. A refund of \$125,900.00 was made in cash, and the price reduced on the remaining units to be manufactured. By time saving methods which have been devised, we expect to be able to make a further refund about August 1 at least equal to the amount of our previous remittance.

The relation of our frequency meter production as to the number of parts and amounts sub-contracted is referred to in Graphs C and D.

ELECTRONIC RELAY

The electronic relay is an entirely new development by E. J. Hall Electrical Laboratory and Hoffman Radio Corporation. The entire unit was developed before being presented to the Government. The selling price per unit is \$650.00. Sales have been made to the following Services: The Treasury Department for use by the Federal Bureau of Investigation, The Office of Strategic Service, the Federal Communication Commission and the Navy Department (Development Contract).

The primary function of the electronic relay is for the noise reducing or noise eliminating from communication equipment. It treats unmodulated signals as though they were stationary frequency

Petitioner's Exhibit No. 2—(Continued)

modulation signals. In other words, it is as though at the peak of frequency swing de-modulation suddenly halted. At this point, a discriminator will produce a constant d.c. output voltage.

This equipment may be incorporated for use with code reception, pulse reception such as used in radar, or for use as a controller circuit in operating squelch circuits, carrier operated recording devices and similar equipment.

The present models of the electronic relay have been made in the form of adaptors, some to be used in conjunction with the Navy superheterodyne receivers as commonly used aboard ship and others for use on aircraft.

This equipment has been successfully used aboard ship where certain types of noise are encountered, in tropical regions where static conditions exist, and in the arctic where a type of noise is created by the aurora. Also, it overcomes noise created by precipitation static and snow static which are of a different character than the ones above mentioned.

The principle of the electronic relay combines in one unit a noise eliminator which meets the demands of conditions from the arctic to the equator.

This equipment is still in the development stage, and during the course of 1944 it is expected that its use will have been found effective with most types of communication equipment.

The relation of our electronic relay production as to the number of parts and amounts sub-contracted is referred to in Graphs C and D.

PETITIONER'S EXHIBIT No. 3

1942 Order Summary

For Bendix Aviation, Ltd.

Job No.	Order No.	Order Date	Item	Quantity	Dollar Value
1	5703-R	2-10-42	Variable Condenser	16,400	\$ 36,455.56
1A	7932-R	5- 7-42	Variable Condenser	15,225	44,761.50
2	7694-R	4-30-42	Antenna Kite	16,224	79,497.60
2A	8108-R	5-23-42	Antenna Kite	16,370	160,262.30
3	6497-R	3-28-42	Parts		6,865.79

For Aviation Radio Laboratory

6	Q55128	6-30-42	Interphone Amplifier	10	1,400.00
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For Kingston Products Corporation

8	45091	9-15-42	Antenna Kite	2,000	19,500.00
9	45096	9-22-42	Tuning Condenser		14,700.00

For Philadelphia Signal Corps

10	12388-Ph-43	9-23-42	Phantom Antenna—A-62		237,726.50
12	13547-Ph-43	10-12-42	Phantom Antenna—A-58		192,980.38

For James Heddons Sons

11	5397	10-5-42	Kite Clusters	17,000	892.50
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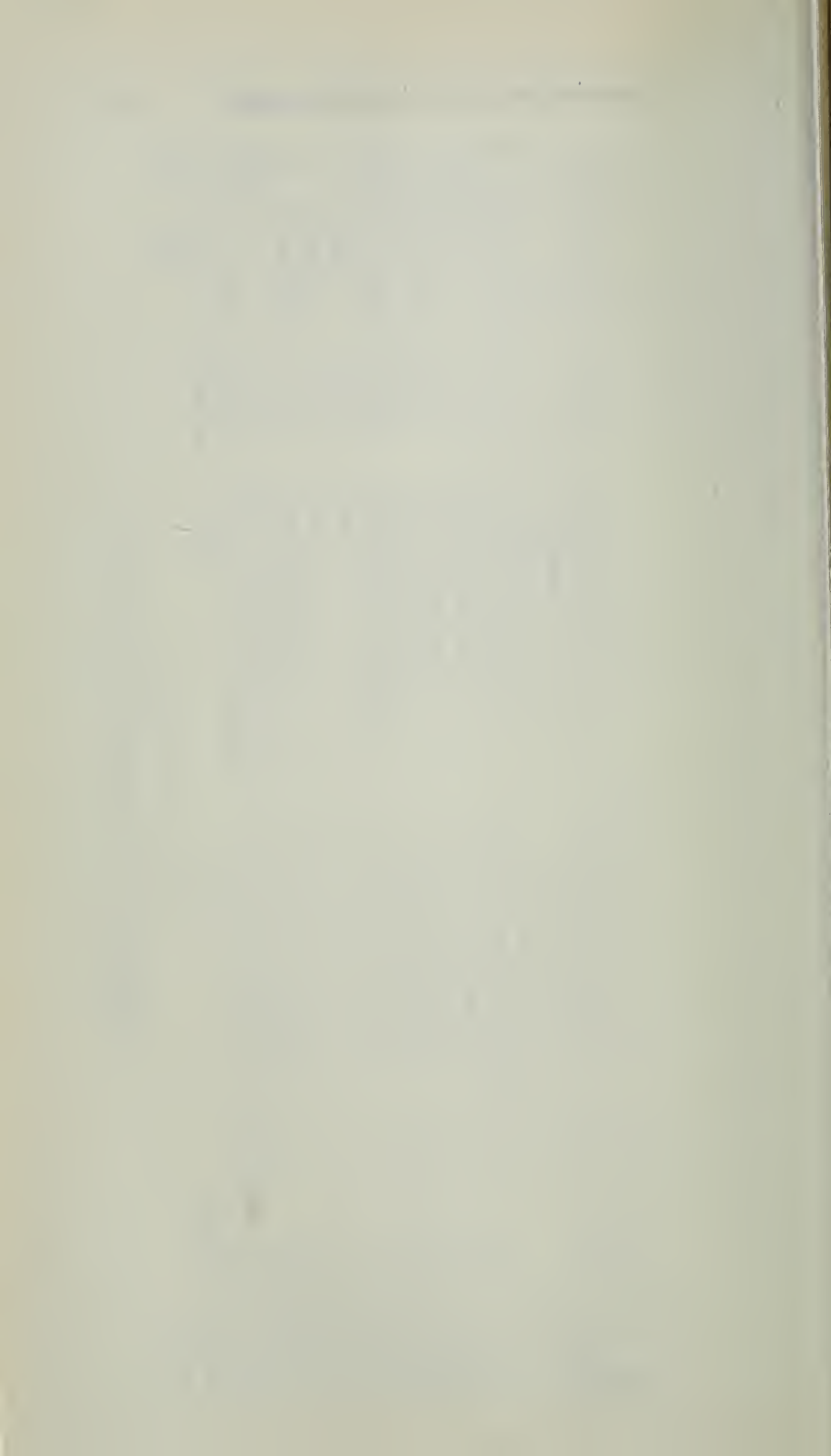
For Navy Department Bureau of Ships/Supplies
and Accounts

15	NXss-19076	12-5-42	Frequency Meters—LM 2,310		3,587,008.00
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PETITIONER'S EXHIBIT No. 4

1943 Order Summary

Job No.	Order No.	Order Date	Item	For	Quantity	Dollar Value
3	(5147W (5278W (5033W (6924R	2- 5-43	Parts.....	Bendix Aviation, Ltd.		\$ 7,680.51
1C	1951W	2-11-43	Variable Condensers.....	Bendix Aviation, Ltd.	25,000	75,500.00
2C	5045W	2-11-43	Antenna Kite.....	Bendix Aviation, Ltd.....	28,000	281,960.00
1D	5220W	2-12-43	Variable Condensers.....	Bendix Aviation, Ltd.	6,400	19,328.00
16	TC-444025	3- 1-43	A-58 Phantom Antenna.....	Wright Field Signal Corps.....	1,118	44,585.84
9D	47526	3-27-43	Tuning Condensers.....	Kingston Products Corp.	16,950	48,833.00
17	5907-43	4- 6-43	Noise Filter.....	Navy Air Station	7	140.00
14	1292	4-30-43	Variable Condensers.....	Marine Radio Service, Ltd.....	1,500	5,175.00
12A	24213-PH-43	5-23-43	A-58 Phantom Antenna.....	Philadelphia Signal Corps	39	1,574.82
17	NXss-31380	6-14-43	Noise Peak Limiter Adaptor.....	Navy Dept., BuSandA	2,280	49,020.00
18-2	C-7307	6-17-43	Electronic Relay Development.....	Treasury Dept.	8	5,200.00



Petitioner's Exhibit No. 5—(Continued)

EXHIBIT "A"

LOAN AGREEMENT

1. The undersigned, Mission Bell Radio Mfg. Co., Inc., (hereinafter called the "Borrower"), has applied to California Bank, (hereinafter called the "Bank"), for a revolving credit to be used by the Borrower in whole or in part, repaid and used again as herein provided up to May 31, 1944 which is the final maturity date of all borrowings under this credit, provided always that the aggregate amount of loans hereunder outstanding at any one time shall not exceed \$400,000.00, and the Bank has agreed to make such loans to the Borrower subject to the terms and conditions herein contained, each such borrowing to be in the amount of \$25,000.00 or multiples thereof (unless the Bank shall otherwise agree), to be evidenced by a promissory note payable to the order of the Bank in the form customarily used by the Bank for similar transactions payable 90 days after date thereof or on May 31, 1944, whichever is earlier, and bearing interest at 4% per annum payable at the end of each calendar month.

2. To induce the Bank to make loans hereunder the Borrower represents, warrants and agrees that:

(a) The Borrower is and will continue to be a duly organized and existing corporation and is duly authorized to make and perform this Agreement and is and will continue to be duly authorized to execute and deliver the notes to be executed pur-

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

suant hereto and the assignments, certificates and other instruments herein provided for at the time of each such delivery; and prior to the delivery of the first note hereunder the Borrower will deliver to the Bank, in form satisfactory to counsel for the Bank, the opinion of counsel for the Borrower that the Borrower is so organized and has such authority and that the officers designated in said opinion have authority to execute this Loan Agreement, said notes, assignments, certificates or other instruments herein provided for;

(b) Proceeds of the borrowings under this credit shall first be used to pay all loans and advances made to Borrower by the Bank prior to the execution of the Guarantee Agreement herein elsewhere referred to and thereafter to pay labor, material, and/or other costs or expenditures in performing War Production Contracts, (including expenditures for such equipment applicable to the contracts which upon completion of said contracts is to become the property of the United States Government), and to pay the installments of principal and interest, as they become due, on the obligation incurred by Borrower for the purchase of its plant;

(c) The financial statement of the Borrower as of April 30, 1943, heretofore furnished to the Bank, is true, correct and complete, and there has been no material adverse change in Borrower's financial condition since that date and, except for the liabil-

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

ity, if any, which may result from the renegotiation of War Production Contracts, the Borrower has no contingent liabilities not provided for or disclosed in said financial statement and there is no litigation or governmental or other proceeding or matter presently pending or, to the knowledge of the officers of the Borrower, threatening against the Borrower.

3. The Bank is not obligated to make any loan hereunder unless at the time the Borrower applies for such loan:

(a) There shall have been no material adverse change in the financial condition of the Borrower from that stated herein;

(b) No litigation or governmental or other proceeding or matter (other than for the renegotiation of War Production Contracts), which if decided against the Borrower would substantially adversely affect the Borrower shall have been instituted against the Borrower or, to the knowledge of the Borrower, be threatened;

(c) Borrower shall have duly observed every condition and performed every agreement on its part herein set forth;

(d) The unpaid principal amount of all loans hereunder then outstanding, plus the loan applied for, shall not exceed the sum of:

(i) 25% of the aggregate dollar amount of the unfilled portion or portions of War Production Contracts which have not been cancelled or ter-

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

minated, less the total amount of the inventory and materials referred to in (ii) below and the receivables referred to in (iii) below; plus

(ii) 70% of the cost of finished or unfinished inventory or raw materials acquired or produced in connection with War Production Contracts which have not been cancelled or terminated; plus

(iii) 90% of the receivables arising from deliveries of finished products in connection with War Production Contracts; plus

(iv) 50% of the reimbursable cost of finished or unfinished inventory or raw material acquired or produced in connection with War Production Contracts which have been cancelled or terminated—the War Production Contracts referred to in the foregoing sub-sections (i) to (iv) inclusive being contracts the proceeds of which are assigned to the Bank as herein provided and the term "War Production Contracts" being defined as hereinafter stated in this Agreement;

(e) The Borrower shall furnish to the Bank a certificate dated as of the date of such application certifying as to the continued existence of the conditions set forth in the foregoing sub-paragraphs (a) to (d), both inclusive;

(f) There shall have been no change in the management of the Borrower which the Bank considers materially adverse to its interests;

(g) A Guarantee Agreement covering the loans hereunder, pursuant to Regulation V and Executive

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

Order No. 9112, shall then be in full force and effect, and there shall be no controversy under said Guarantee Agreement or any of the War Production Contracts referred to herein or therein, and the Guarantor shall be obligated by the Guarantee Agreement to purchase the "guaranteed percentage" of any and all of the Bank's loans hereunder as defined in the Guarantee Agreement and the Guarantor shall not have denied in writing that it is so obligated to make such purchase;

(h) A Guarantee Agreement or Agreements covering the loans hereunder executed by H. L. Hoffman, Walter D. Douglas II and G. Clifford Davidge or such of them as may be required by the Bank and Guarantor in connection with the guarantee referred to in sub-paragraph (g) of this paragraph (each of said Guarantors being severally liable thereon) in such form and for such amounts as may be satisfactory to the Bank and said Guarantor, shall then be in full force and effect.

4. All loans made hereunder shall be secured by assignment of proceeds of War Production Contracts which are now in full force and effect and are described in the attached Exhibit "A", including the proceeds of all amendments, additions and supplements thereto. The Borrower agrees that said War Production Contracts will not be amended, consolidated or rewritten, except upon request of the Government and in the event of such request the Borrower will notify the Bank of

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

any changes in said War Production Contracts and if requested by the Bank the Borrower will provide the Bank with further or additional assignments to fully cover all such amendments, additions, consolidations or rewrites. The Borrower further agrees, upon request of the Bank, to assign to the Bank, in form and manner satisfactory to the Bank, all sums and amounts due and/or to become due under all War Production Contracts heretofore or hereafter entered into by Borrower and not described in attached Exhibit "A". For the purposes of this Loan Agreement the term "War Production Contract" shall be defined in the same manner as that term is defined in the Guarantee Agreement referred to in subsection (g) of paragraph numbered 3 hereof.

5. All moneys received by the Bank by virtue of any assignments executed and delivered pursuant to this Agreement shall, at the Bank's option either be applied directly toward the payment of any of Borrower's indebtedness to the Bank which is secured by such assignments or be deposited by California Bank in a special non-interest bearing account at said Bank in the name of the Bank as Assignee of the Borrower, which account shall be subject to the sole control of the Bank and such account and all moneys placed therein shall at all times be construed to be and the same are assigned to the Bank as security for all loans hereunder, including interest and any other amounts

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

becoming due to the Bank from the Borrower. If such moneys shall be so deposited they shall be held until the balance in said account shall equal at least \$25,000.00, at which time \$25,000.00 of such balance or such greater amount, if any, as the Bank elects, shall be applied on any of such indebtedness; provided, however, that the Bank may at any time in its discretion apply on said indebtedness any lesser amount than in said account. As long as said Guarantee Agreement remains in effect, any such application shall be subject to the provisions thereof. If, notwithstanding any such assignment or assignments, any moneys, checks, drafts or orders for the payment of money shall be received by the Borrower direct from the other contracting party to any War Production Contract, the proceeds of which are assigned to the Bank as stated in this Agreement, such moneys, checks, drafts or orders for the payment of money shall be received by the Borrower in trust and shall not be intermingled with the general funds of Borrower and shall be immediately paid or delivered to the Bank for application in the aforesaid manner.

6. While any of the revolving credit granted to the Borrower under this Agreement is in use or available to it and so long as any of the notes evidencing loans under this Agreement are unpaid the Borrower agrees that:

(a) Without the prior written consent of the Bank and the prior written consent of the Federal

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

Reserve Bank of San Francisco, as Fiscal Agent of the United States acting on behalf of the Guarantor named in the Guarantee Agreement herein referred to, the Borrower will not

(i) Create or incur any indebtedness other than for normal operating requirements of its business, or borrow funds other than from the Bank under the credit provided for in this Agreement, or request, or take or accept advances, or advance payments, or loans on any of its War Production Contracts;

(ii) Further mortgage, pledge, hypothecate or otherwise encumber any of its assets except to the Bank;

(iii) Make any expenditures for land, buildings, machinery, equipment and/or other fixed assets except expenditures for such equipment applicable to the contracts which upon completion of said contracts is to become property of the United States Government;

(iv) Declare or pay any cash dividends upon its capital stock or acquire any of its outstanding stock or otherwise make any change in its capital structure, or merge or consolidate with or into any other corporation, or convey, sell, lease or transfer assets the ownership of which is necessary to the continuance of its business;

(v) Assume any liability by way of guarantee, endorsement or otherwise, on obligations of others;

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

(vi) Make any loans to, or for, its officers, directors or stockholders;

(vii) Make, directly or indirectly, any investment of any kind in, or advance of any kind to, any other business organization whether conducted by an individual, partnership, corporation or association;

(viii) Permit Borrower's officers and/or directors to withdraw more than the aggregate sum of \$1,500.00 cash per calendar month as salaries, or to make any cash payments to Borrower's officers or directors as fees, bonuses or otherwise except pursuant to agreements which were already in effect on January 1, 1943;

(ix) Permit its net working capital, as calculated by good accounting practice, to be reduced below \$30,000.00 and in such calculation of net working capital the tax reserves hereinafter provided for shall be treated as current liabilities;

(x) Enter into any new contract involving more than \$50,000.00 as the total contract price except when requested or required by the United States Government;

(b) At the end of each monthly period the Borrower will provide reserves for State and Federal income, surtax and excess profits taxes applicable against earnings accrued to date to the best of its knowledge and in accordance with accepted accounting principles;

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

(c) The Borrower will maintain insurance cover as satisfactory to the Bank at all times;

(d) The Borrower will duly pay and discharge all taxes, assessments and governmental charges levied upon or against it, including (but not by way of limitation) Federal income and excess profits taxes and all real and personal property taxes when and as such taxes shall become due and payable, unless and to the extent only that such taxes shall be contested in good faith by the Borrower;

(e) Any indebtedness of the Borrower in favor of stockholders, officers and/or directors of the Borrower shall be subordinated to all loans made hereunder;

(f) Within sixty (60) days after the end of each month, or as often as the Bank may reasonably request, the Borrower will provide the Bank with a monthly report of its affairs in duplicate, including balance sheet, profit and loss statements for the month and for the year to date, together with the usual supporting schedules, and complete information concerning all cancelled War Production Contracts, if any, and Borrower will also furnish to the Bank, if the Bank so requests, copies of an annual audit of the accounts of the Borrower as prepared by an independent accountant satisfactory to the Bank, including the certificate and accompanying comment of such accountant. The Borrower will permit the Bank or its

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

authorized representatives at any reasonable times to examine the books and records of the Borrower and to take memoranda and extracts therefrom;

(g) To the extent that the furnishing thereof shall not violate any Federal law or regulation, the Borrower will notify the Bank of any breach, termination, violation or cancellation of or material adverse change in any War Production Contract to which the Borrower is a party. Any such notice shall be delivered to the Bank within ten (10) days after the occurrence of the event to which such notice relates. The Borrower will promptly give the Bank notice of any litigation, or governmental or other proceeding or matter in which the Borrower is involved;

(h) The Borrower will at all times conduct its business in an efficient and businesslike manner and will preserve and maintain all buildings and equipment (except as may no longer be necessary or desirable in the conduct of its business), in thorough repair, working order and condition, and from time to time will make all needful and proper repairs, renewals, replacements, additions and betterments;

(i) Borrower will punctually pay all principal and interest as the same falls due on all notes executed pursuant to the terms of this Agreement; provided, however, that the Borrower shall have ten days within which to pay any note which shall

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

become immediately due and payable because of the termination of suspension of maturity in accordance with the provisions of sub-paragraph (c) of Section 6 of said Guarantee Agreement;

(j) Should the Guarantor named in the Guarantee Agreement hereinbefore referred to request the modification of this Loan Agreement in any respect, then the Borrower will upon request of the Bank give its written consent to such modification;

(k) The Borrower agrees that in the event it obtains a suspension of maturity pursuant to Section 6 of the Guarantee Agreement in respect of a portion of the indebtedness evidenced by any Note in favor of the Bank, it will, upon request of the Bank, execute two Notes in exchange for such Note, one of which new Notes will evidence the suspended portion of the Note so exchanged and the other the unsuspending portion of the Note so exchanged. Each such new Note shall bear the same date as, and the same specified maturity as, the Note so exchanged.

7. In the event of the breach by the Borrower of any agreement herein or hereafter made or if any statement or representation furnished in connection herewith or pursuant hereto shall be or shall become untrue; or in the event of the cancellation of any of the Borrower's War Production Contracts for any reason other than the convenience of the United States Government; or if there

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

shall be any change in the financial condition of the Borrower which the Bank considers materially adverse; or in the event the Guarantee Agreement to the Bank shall at any time not be in full force and effect or the Guarantor thereunder shall fail to refuse to comply with all of its obligations thereunder; or in the event that the Borrower shall commence or become a party to any proceedings under the United States Bankruptcy Laws in which it is alleged that the Borrower is bankrupt or in which the benefit of the provisions of any bankruptcy statute are claimed by or for the Borrower; or in the event of the insolvency of the Borrower or of the appointment of a Receiver for the Borrower's assets or business or of the voluntary dissolution of the Borrower; or if there shall be a seizure or other appropriation by the United States, or any of its agencies, of any of the property of the Borrower, if such seizure or appropriation shall adversely affect the operations of the Borrower; then in either or any of such events the Bank may, at its option and without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived, declare all indebtedness of the Borrower to the Bank immediately due and payable, anything to the contrary contained herein or in any note or in the Guarantee Agreement or in any other documents notwithstanding, subject, however, to the consent of the Guarantor if and as such

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

consent shall be required under the Guarantee Agreement.

8. No delay on the part of the Bank in the exercise of any power or right shall operate as a waiver thereof, nor shall any single or partial exercise of any power or right preclude other or further exercise thereof, or the exercise of any other power or right, and nothing in this Agreement shall obligate the Bank to take action in event of default.

9. All money and property of the Borrower at any time in the possession or control of the Bank shall be subject to set-off, and are hereby pledged to the Bank as security for all liabilities of the Borrower to the Bank whether or not and however such liabilities may be secured.

10. The right to plead any and all statutes of limitations as a defense to any demand or action or proceeding to recover upon any note executed to this Loan Agreement is hereby waived.

11. The proceeds of each loan made hereunder shall, at the option of the Bank, be credited to the Borrower's account in the California Bank and such crediting shall be construed as delivery of such proceeds to the Borrower.

12. This Agreement and the notes hereunder shall be governed by the laws of the State of California.

Petitioner's Exhibit No. 5—(Continued)

Exhibit "A"—(Continued)

13. The benefits of this Agreement shall extend and be available to each holder of the notes hereunder.

Dated at Los Angeles, California, as of July 10, 1943.

MISSION BELL RADIO MFG.
CO., INC.,

By /s/ H. L. HOFFMAN,

By /s/ R. A. YARCHO,

CALIFORNIA BANK,

By /s/ (Illegible.)

EXHIBIT "A"

SCHEDULE OF ASSIGNED CONTRACTS

Date, 9/22/42; Contract No., W-2124-sc-6519; Department: Army; Description: Phantom Antenna; Original Amount: \$333,549.60. Contracting Officer—First Lieut. Allan Hill.

Date: 12/5/42; Contract No.: NXss-19076; Department: Navy; Description: Frequency Measuring Radio Equipment; Original Amount: \$1,540,000.00 (Estimated). (Letter of Intent.) Contracting Officer: C. C. Jaquette, (Purchasing Officer.) Price to be negotiated.

Respondent's Exhibit B—(Continued)

Treasury Department
Internal Revenue Service
Los Angeles 13, Calif.

August 30, 1943

Salary Stabilization Unit
Suite 770, Subway Terminal Bldg.
ENH

Mission Bell Radio Mfg. Co., Inc.
3430 South Hill Street
Los Angeles, California

Attention: Mr. R. A. Yarcho, Secretary

Sirs:

Reference is made to your letter dated August 9, 1943, requesting approval of salary rate ranges for eight positions in your company.

Based on the information furnished approval is hereby given to the following salary rate ranges for the positions indicated:

	Monthly Rate	
Purchasing Agent	\$250	\$400
Outside Production Supervisor	250	450
Expeditor	250	400
Section Engineer	350	500
Senior Engineer	275	350
Junior Engineer	225	275
Draftsman (Engineer)	225	300
Sales Engineer	400	500

It is understood that increases made under the authority of the approval of this salary rate schedule shall not be used as a basis for other wage or salary adjustments, or to increase the level of

Respondent's Exhibit B—(Continued)

production costs appreciably or furnish the basis either to increase prices or to resist otherwise justifiable reductions in prices.

Increases in the basis compensation of employees in any of the foregoing groups are restricted to your established practice as to frequency, and no individual is to receive a merit increase in a twelve-month period in excess of 15% of his salary on the year's beginning date. It is not contemplated that approval of these ranges is an authorization to make blanket increases contrary to your established practice or to increase the weighted average salary paid to each job classification in excess of 3%.

This ruling is based upon the information contained in your letter referred to above. If the information is subsequently found to be incorrect, this ruling shall have no force or effect.

By direction of the Commissioner:

/s/,

Head, Los Angeles Office.

ring.

Respondent's Exhibit B—(Continued)

National War Labor Board
Tenth Region

1355 Market Street
San Francisco, California

Date of Board Action, March 20, 1943

In the Matter of: Mission Bell Radio Manufacturing Company, Incorporated: Case No. 10-529 (Los Angeles, California)

AUTHORIZATION

The Regional War Labor Board for the Tenth Region, acting as the duly authorized agent of the National War Labor Board and pursuant to the powers vested in said Board by Executive Order 9017 of January 12, 1942 and 9250 of October 3, 1942, hereby unanimously approves with modifications the requested wage adjustments filed December 22, 1942 by Mission Bell Radio Manufacturing Company, Incorporated, effective as of March 20, 1943 with the following modifications:

Classification	Approved Rate
Material Control	
Storekeeper.....	\$1.00
Shipping Clerk.....	1.00
Receiving Clerk.....	1.00
Purchasing Clerk.....	.73
Engineering	
Junior Engineers.....	\$1.00
Receiving Inspector.....	.80 to \$1.00

Respondent's Exhibit B—(Continued)

Classification	Approved Rate
Office	
Bookkeeper.....	\$.84
Accountant.....	1.11
Timekeeper.....	.85
Stenographer.....	.73
Secretary.....	.84
Switchboard Operator.....	.73
Factory—General	
First Week.....	\$.60
2nd to 11th Week, Inclusive.....	.65
12th to 23rd Week, Inclusive.....	.70
24th Week and up.....	.75
Specialized Labor.....	\$.05 to \$.25 over Basic Rate
Punch Press & Machine Operator.....	.05 over basic
Line Inspectors.....	.05 over basic
Condenser Adjuster.....	.10 over basic
Power Solderer.....	.10 over basic
Line Mechanics.....	.25 over basic
Radio Assemblers.....	.10 over basic
Group Leaders.....	\$.10 over basic
Maintenance Engineers.....	1.00 to \$1.20
Head Carpenter.....	1.20
Carpenter.....	.90
Carpenter's Helper.....	.75
Mechanic.....	.90 to \$1.35
Tool Maker.....	1.40 to 1.50*
Personnel Manager.....	\$225 to \$275.00 per mo.

* Not more than 10% of total number of employees in this classification may be paid at rates over \$1.45.

TENTH REGIONAL WAR LABOR BOARD

By
Chairman.

Respondent's Exhibit B—(Continued)

Treasury Department
Internal Revenue Service
Los Angeles 13, Calif.

Salary Stabilization Unit
Suite 770, Subway Terminal Bldg.
ENH.

August 30, 1943

Mission Bell Radio Mfg. Co., Inc.
3430 South Hill Street
Los Angeles, California

Attention: Mr. R. A. Yarcho, Secretary.

Sir:

Reference is made to your letter dated August 9, 1943, requesting approval to pay additional compensation to your employees due to an extension of the work week from 44 to 48 hours.

Based on the information furnished, approval is hereby given for payment of additional compensation per month to employees in the following salary classifications, so long as they are required to work 48 hours per week, and represents payment for work performed on the sixth consecutive day in any work week:

Up to \$199—per month. Time and one-half.

Over \$200, but not over \$249 per month, 80% of time and one-half.

Over \$250, but not over \$299 per month, 60% of time and one-half.

Respondent's Exhibit B—(Continued)

Over \$300, but not over \$324 per month, 40% of time and one-half.

Over \$325, but not over \$349 per month, 20% of time and one-half.

The number of dollars of increase granted is understood to include all payments to which the employee is entitled under any Federal or State law, or Executive order.

It is understood that the adjustments hereby approved shall not be used as a basis for other wage or salary adjustments or to increase the level of production costs appreciably or furnish the basis either to increase prices or to resist otherwise justifiable reductions in prices.

This ruling is based upon the information contained in your letter referred to above. If the information is subsequently found to be incorrect, this ruling shall have no force or effect.

By direction of the Commissioner:

/s/
Head, Los Angeles Office.

rng.

CERTIFIED COPY OF RESOLUTION

“Whereas, it is deemed to be to the best interests of this corporation that its articles of incorporation be amended to adopt a new name.

“Now, Therefore, Be It Resolved that the articles of incorporation of this corporation, Mission Bell

Respondent's Exhibit B—(Continued)

Radio Mfg. Co., Inc., a California corporation, be and they hereby are amended so that Article One thereof, which now reads: 'The name of this corporation is Mission Bell Radio Mfg. Co., Inc.' shall read as follows: 'The name of this corporation is Hoffman Radio Corporation.'

"Resolved Further that the foregoing amendment is advisable and that the president or vice-president and the secretary or an assistant secretary of this corporation be and they hereby are authorized, empowered and directed to procure the approval of this resolution by the vote or written consent of the shareholders of this corporation holding at least a majority of the voting power, regardless of limitations or restrictions on the voting power thereof, and thereafter to execute and verify by their oath and to file a certificate in the form and manner required by Section 362-B of the California Civil Code, and in general to do any and all things necessary to effect such amendment in accordance with all provisions of law applicable thereto."

The undersigned, R. A. Yarcho, hereby certifies that he is now and at all the times herein mentioned was the duly appointed and acting secretary of Mission Bell Radio Mfg. Co., Inc.; that the foregoing is a full, true and correct copy of a resolution of the board of directors of Mission Bell Radio Mfg. Co., Inc., adopted at a special meeting of the directors thereof held on November 3, 1943;

Respondent's Exhibit B—(Continued)

that said resolution is now in full force and effect and has not been modified, repealed, supplemented or amended.

The undersigned hereby further certifies that the corporate name of Mission Bell Radio Mfg. Co., Inc., was changed to Hoffman Radio Corporation by amendment to the articles of incorporation of Mission Bell Radio Mfg. Co., Inc., filed in the office of the Secretary of State of the State of California on November 12, 1943. A certified copy of said certificate of amendment of articles of incorporation was filed in the office of the County Clerk of Los Angeles County, California, November 15, 1943.

In Witness Whereof, the undersigned has executed this certification and hereunto affixed the corporate seal of Hoffman Radio Corporation this 14th day of March, 1944.

(Seal) /s/ R. A. YARCHO,

Secretary of Hoffman Radio Corporation, formerly
Mission Bell Radio Mfg. Co., Inc.

HOFFMAN RADIO CORPORATION

Item 28. Amortization of Emergency Facilities:

Building under C. of N.....	\$ 5,500.02
Special Construction and Equipment spread over Contract to become property of Navy on Contract completion	34,446.00
	<hr/>
	\$39,946.02

Respondent's Exhibit B—(Continued)

Item 29. Other Deductions:

Real Estate Expense	\$ 133.91
R. C. A. License charge off.....	760.92
Officers Travel—War Orders	5,293.18
Property Maintenance, Repair and Upkeep.....	4,529.29
Postage, Stationery and Supplies.....	6,201.73
Dues and Subscriptions	1,046.46
Telephone and Telegraph.....	7,823.48
Legal Fees	3,500.53
General Administration Expense	2,253.05
Advertising	6,872.38
Insurance Expense	1,242.00
Contributions	1,506.79
Employees Trust Fund	10,507.53
	\$51,671.25

Schedule A. Other Costs:

Freight in	\$ 9,524.70
Production Supplies for Eleven Contracts.....	22,256.23
Special Production Materials	4,115.46
Emergency Expense	9,779.39
Employee Relationship Expense	7,413.70
Factory and Janitor Supplies.....	6,184.80
Heat, Light and Power.....	3,134.17
Rent	6,622.84
Insurance Expense	5,342.03
Repair, Upkeep and Maintenance.....	7,091.80
Small Tools	2,720.35
Truck and Auto Expense.....	2,908.47
Amortization of Dies and Jigs.....	11,952.09
Remodeling Expense	27.88
Less Miscellaneous Receipts	3,103.37
	\$95,970.54

Any decrease in the excess profits tax under Chapter 2-E will result in a reduction in the amount of the post-war credit computed under Sections 780 and 781 of the Internal Revenue Code. In accordance with the provisions of Section 781

Respondent's Exhibit B—(Continued)

(b) of the Internal Revenue Code, any post-war refund bonds previously issued for the year involved are to be made available, where necessary, in order to effect the reduction. After receiving notification of the conclusion of the renegotiation settlement the Commissioner of Internal Revenue will request the taxpayer to return the bonds. If refund bonds are not made available for the purpose of the required reduction, the amount of such reduction shall be paid by the taxpayer to the United States.

Please furnish this office, in duplicate, as soon as the renegotiation settlement is finally concluded, the amount of the offsetting tax credit allowed in the settlement.

Very truly yours,

/s/ GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

BIS:vs co this letter enclosed to taxpayer.

Respondent's Exhibit B—(Continued)

(Return)

417 South Hill Street

October 23, 1944

LA:FA:EIS

In re: Hoffman Radio Corporation, 3430 South Hill Street, Los Angeles, California. Year ended December 31, 1943.

Army Service Forces
Signal Corps Analysis Agency
169 11th Street
San Francisco 3, California

Gentlemen:

Reference is made to the renegotiation of war contracts in the above designated case, involving an offsetting tax credit, as provided in section 3806(b) of the Internal Revenue Code, against the amount of the excessive profits to be eliminated to the extent by which the taxes for the taxable year are to be decreased by reason of the application of the provisions of paragraph 1 of subsection (a) of section 3806.

On the basis of the retained copies of returns presented by the taxpayer for the above-mentioned taxable year, and upon the understanding that profits in the amount of \$51,192.00, which have been determined to be excessive were included in income in the returns, and amounts by which the taxes for the taxable year covered by such returns are decreased by reason of the application of para-

Respondent's Exhibit B—(Continued)

graph (1) of subsection (a), for the purposes of section 3806(b)(1) of the Internal Revenue Code, are as follows:

Income tax and surtax, Chapter 1, None; surtax, Chapter 2A, None; declared value excess profits tax, Chapter 2B, \$782.57; tax under Chapter 20, None; excess profits tax, Chapter 2E, \$43,448.84; aggregating \$44,231.41. Provided, it be further understood that the computation of the foregoing amounts has been based upon the assessments made to date of such taxes, whether or not paid.

War Department
Headquarters, Army Service Forces
Office of the Chief Signal Officer
Washington, D. C.

SPSFD

18 December, 1944

[Stamp]: Received Dec. 26, 1944. Internal Revenue Agent in Charge, Los Angeles Division.

Internal Revenue Agent in Charge,
Internal Revenue Service,
417 South Hill Street,
Los Angeles 13, Calif.

Re: Hoffman Radio Corporation, 3430 South Hill Street, Los Angeles, California.

Dear Sir:

This is to advise that a tax credit allowance of \$44,231.41 as set forth in your letter of 23 October, 1944, file LA:FA:EIS, has been applied as a

Respondent's Exhibit "B"—(Continued)

credit against the payment under the terms of Renegotiation Agreement W-49-073-sc-PAS-151 with the above company for the taxable year ended 31 December, 1943.

Very truly yours,

/s/ M. F. SAIKLEY,
Major, Signal Corps,
Fiscal Division.

(Return.)

417 South Hill Street
January 15, 1945

LA:FA:EIS

In re: Hoffman Radio Corporation, 3430 South Hill Street, Los Angeles, California. Year: 1943.

Commissioner of Internal Revenue,
Washington 25, D. C.

Attention: IT:C 1:CC.

In accordance with instructions contained in paragraph 8 of Com. Mim. R. A. No. 1294, dated July 5, 1943, this letter is forwarded. There is impressed hereon the appropriate stamp disclosing the amount of offsetting credit under Section 3806 (b) of the Code allowed the taxpayer in contract renegotiation settlement covering the year 1943.

The stamp has been accomplished also in accordance with instructions contained in paragraph 8 of the mimeograph, and has, as required by the

Respondent's Exhibit "B"—(Continued)

mimeograph, been impressed upon the necessary returns of the taxpayer.

/s/ GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

EIS:vs

[Stamp]: Int. Rev. Agt. in Charge of Los Angeles Division, Credit Sec. 3806(b), I.R.C., \$44,231.41. Tax Year, 1943. Chap. 2B, \$782.57. Chap. 2E, \$43,448.84. Notification date: 12/18/44.

Treasury Department
Office of Commissioner of Internal Revenue
Washington

IT:C1:CC

NOTICE OF ALLOWANCE OF TENTATIVE
AMORTIZATION ADJUSTMENT

[Stamp]: Revenue Agent in Charge, Los Angeles Division. Received Apr. 1, 1946.

Allowed: \$4,915.54.
Year: 1943. (Conf.)
Schedule No.: AM 11.

Hoffman Radio Corporation
3430 South Hill Street
Los Angeles 7, California

Gentlemen:

Overassessment: Excess Profits Tax \$5,416.71
Less: Post-war Credit Reduction... 546.17

Your application for Tentative Adjustment with respect to Amortization Deduction, under section

Respondent's Exhibit "B"—(Continued)

124 of the Internal Revenue Code, as amended by section 7 of the Tax Adjustment Act of 1945, has been allowed in the amount and for the year stated above. Such amount has been abated, credited, or refunded in accordance with the status of your tax accounts for the year(s) involved, as indicated below.

This allowance is a tentative adjustment and subject to change upon final audit and determination of the tax liability for the year involved.

To the extent your application is not allowed for the year indicated above, it is disallowed, and this is the notice of disallowance.

A check for the amount refundable, together with allowable interest, is transmitted herewith. The interest must be included in your income tax return for the year or period in which received.

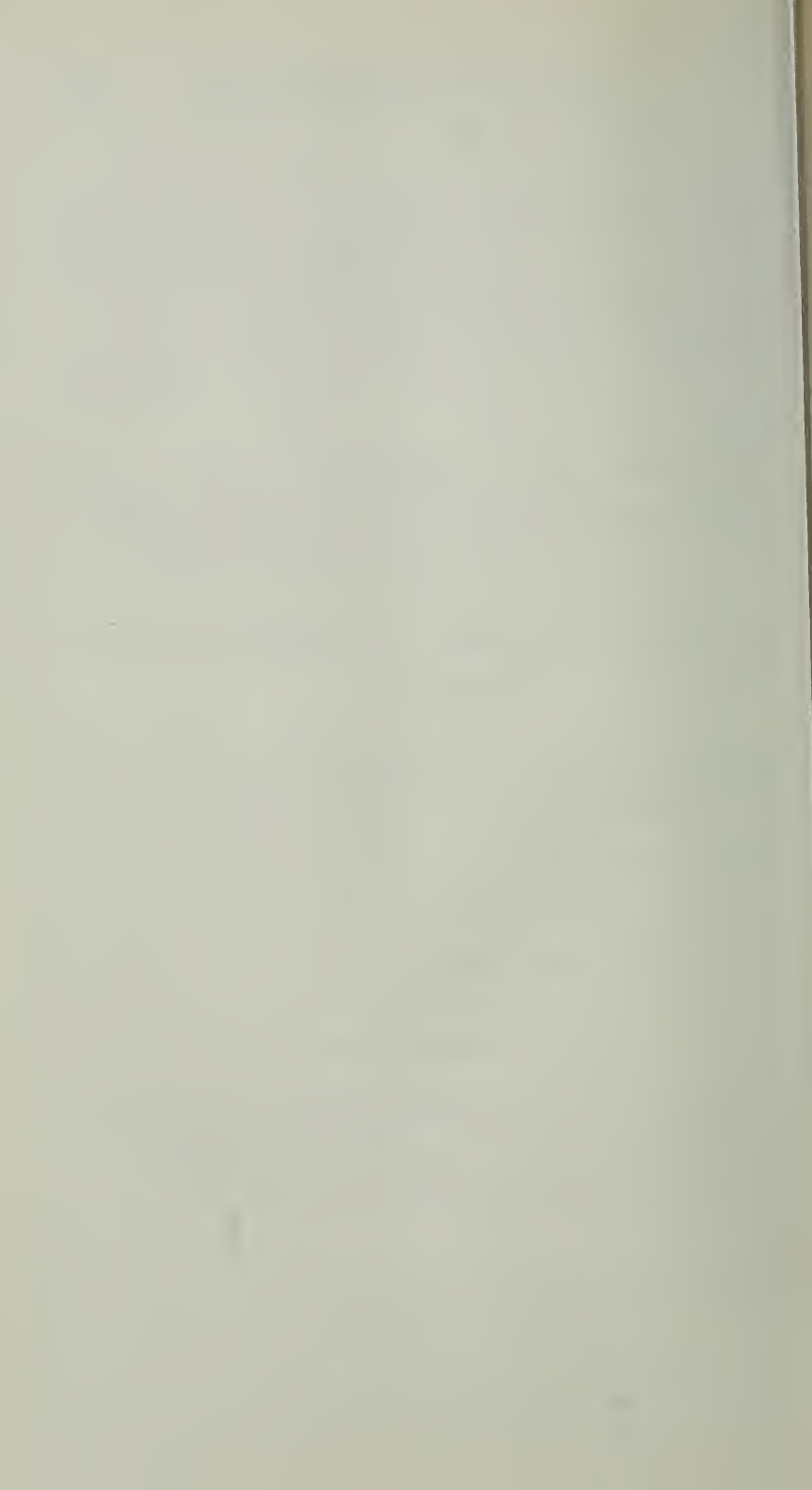
By direction of the Commissioner:

Very truly yours,

.....,

Deputy Commissioner.

Abated: \$. . . . Credited: \$4,915.54, to tax year 1944. Credited: \$. . . . to tax year. Refunded: \$. . . . Interest: \$327.70. Form 7781. Nov. 7, 1945.



APPLICATION FOR TENTATIVE ADJUSTMENT WITH RESPECT TO AMORTIZATION DEDUCTION

(Under section 127 of the Internal Revenue Code, as amended by section 7 of the Tax Adjustment Act of 1945)

FOR USE BY CORPORATIONS WHICH—

- (1) Have elected to terminate the amortization period with respect to an emergency facility; and
- (2) Desire a tentative adjustment with respect to the amortization deduction.

THIS FORM MUST BE FILED WITH THE COLLECTOR OF INTERNAL REVENUE WHERE ASSESSMENT WAS MADE OR TAX PAID

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

HOFFMAN RADIO CORPORATION
(Name)

3430 SOUTH HILL STREET
(Street and number)

LOS ANGELES 7, CALIFORNIA
(City or town, postal zone number) (State)

COLLECTOR'S STAMP

Date Received

Item and Instruction No.:

1. Taxable year in which this application is filed:
 - (a) Calendar year 1945, or
 - (b) Fiscal year beginning 194, and ending 194.
2. Taxable years prior to the taxable year stated in Item 1 which are affected by the revised amortization deduction Calendar Years 1943 and 1944
3. Description of facility and amortization period:

(a) Facility	(b) Necessity Certificate No.	(c) Date on which amortization period began	(d) Date on which statement of election to terminate amortization period was filed	(e) Date on which amortization period ended under section to terminate	(f) Authority for terminal amortization period. (If non-necessity certificate show number and date)
* Land	NI-N-6239	7-1-43	10-8-45	9-30-45	Proclamation
* Building	"	"	"	"	"
* Power Equipment	"	"	"	"	"

* See copy of Certificate of Necessity attached for description.

If more space is needed, list data on separate sheet of paper and attach to this application.

4. Amount by which taxes previously determined for each taxable year specified in Item 2 are increased or decreased by reason of the revision of the amortization deduction and any related adjustments. (Attach schedule showing computation of the taxes previously determined and of the increases or decreases in such taxes.)

Taxable Year Ended	Income Tax		Declared Value Excess-Profits Tax		Excess Profits Tax	
	Increase	Decrease	Increase	Decrease	Increase	Decrease
12-31-43	\$ 3,121.30	\$ -	\$ None	\$ None	\$ -	\$ 4,915.00
12-31-44	7.53	-	None	None	-	9,769.00

If any other tax is affected by reason of the revision of the amortization deduction, attach schedule showing increases or decrease in such tax previously determined.

5. Unpaid amount of each tax (including any installments not yet due) for each taxable year specified in Item 2:

Taxable year ended	Amount unpaid			
	Income Tax	Declared Value Excess-Profits Tax	Excess Profits Tax	Other Tax (Specify Tax)
12-31-44	\$ 750.81	\$ None	\$ 76,940.95	\$ None

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accountant officer) of the corporation for which this application is made, being severally duly sworn, each for himself deposes and says that this application (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief a true and complete statement, made in good faith, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 16 day of Oct, 1945

Hoffman
(Signature of President, Vice President, or other principal officer)

Reynolds
(Signature of Treasurer, or Chief Accounting Officer)

(Notarial Seal)
Pearl Anderson

NOTARY PUBLIC
In and for the County of Los Angeles, State of California

(Corporate Seal)

Respondent's Exhibit "B"—(Continued)

CERTIFICATE

I hereby certify that this Application for Tentative Adjustment With Respect to Amortization Deduction, Form 1140, was prepared by me on behalf of the taxpayer and that the facts stated therein are true and correct to the best of my knowledge and belief.

/s/ M. HAYES HALLOCK,

With: Claude I. Parker Partnership, 808 Bank of America Building, Los Angeles 14, California.

Respondent's Exhibit B—(Continued)

HOFFMAN RADIO CORPORATION

APPLICATION FOR TENTATIVE ADJUSTMENT WITH
RESPECT TO AMORTIZATION DEDUCTION

Emergency Facilities Certified in Certificate No. ND-N-6239:

Cost per Certificate of Necessity:

Land—3751 South Hill Street

Los Angeles\$14,000.00

Building—3751 South Hill Street,

Los Angeles 37,000.00

Power Equipment—3751 South Hill

Street, Los Angeles 4,000.00

\$55,000.00

Actual Cost of above Facilities acquired 6/18/43.....\$55,472.23†

55,912.08?*

The above difference is accrued taxes, escrow charges, etc.

Amortization Period as Commuted:

Date Amortization began—7-1-43

Date Amortization ended—9-30-43

Number of Months in Commuted Period:

Year 1943—7/1/43 - 12/31/43 6 Months

Year 1944—1/1/44 - 12/31/44 12 Months

Year 1945—1/1/45 - 9/30/45 9 Months

Total..... 27 Months

Monthly Amortization of Cost under Commuted Period:

\$55,472.23 ÷ 27 =\$ 2,054.527 2,070.817*

Recomputed Amortization Deduction:

Taxable year 1943\$12,327.16 12,424.91*

Taxable year 1944 24,654.32 24,849.81*

Taxable year 1945 18,490.75 18,637.36*

\$55,472.23

55,912.08*

† Figures 472.23 circled in pencil.

* Figures in pencil.

Respondent's Exhibit B—(Continued)

HOFFMAN RADIO CORP.

APPLICATION FOR TENTATIVE ADJUSTMENT WITH RESPECT
TO AMORTIZATION DEDUCTION ADJUSTMENTS UNDER
SECTION 124(d) (5)

YEAR 1943

INCOME TAX 1943

31	Net Income Item 31—Form 1120.....		\$211,857.16
	Renegotiation Adjustment 11/15/44 .....	(	51,192.00)
	Amortization Deduction—Recomputed	\$	12,327.16
	Amortization Deduction—Return	5,500.02	(6,827.14)
		<hr/>	<hr/>
31	Net Income for Declared Value E. P. Tax—revised.....		\$153,838.02
	Declared Value	\$	2,000,000.00
	10% Declared Value	\$	200,000.00
	Credit for Dividends Received.....		.....
		<hr/>	<hr/>
	Subject to Tax .....		.....
	Declared Value Excess Profits Tax.....	None	
	Tax Assessed and Paid—Return \$782.57		
	Credit Under Sec. 3806.....	782.57	None
		<hr/>	<hr/>
	Adjustment Under Sec. 124(d) (5)	None	
31	Net Income as Revised above.....		\$153,838.02
32	Interest on Obligations of U. S.....		.....
34	Declared Value Excess Profits Tax.....		.....
		<hr/>	<hr/>
35	Net Income		\$153,838.02
36	Interest on U. S. Obligations.....		.....
		<hr/>	<hr/>
37	Adjusted Net Income		\$153,838.02
38	Income subject to Excess Profits Tax	\$	141,907.28
39	Dividends Received Credit		141,907.28
		<hr/>	<hr/>
40	Normal Tax Net Income.....		\$ 11,930.74

Respondent's Exhibit B—(Continued)

INCOME TAX—1943—(Continued)

NORMAL TAX

\$5,000.00 at 15%.....	\$ 750.00	
6,930.74 at 17%.....	1,178.23	\$ 1,928.23

Net Income—Item 35—Revised		\$153,838.02
----------------------------------	--	--------------

Income subject to Excess Profits Tax.....	\$141,907.28	
---	--------------	--

Dividends Received Credit		141,907.28
---------------------------------	--	------------

Surtax Net Income		\$ 11,930.74
-------------------------	--	--------------

SURTAX at 10%	\$ 1,193.07	
---------------------	-------------	--

Normal Tax	\$ 1,928.23	
------------------	-------------	--

Surtax	1,193.07	\$ 3,121.30
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42 Credit for Foreign Taxes.....		
----------------------------------	--	--

43 Balance of Income Tax.....		\$ 3,121.30
-------------------------------	--	-------------

Income tax due as above.....		\$ 3,121.30
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Taxes previously assessed and paid		
------------------------------------	--	--

Income tax per return		
-----------------------------	--	--

Credit under Sec. 3806		
------------------------------	--	--

Adjustment under Sec. 124(d) (5).....		\$ 3,121.30
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EXCESS PROFITS TAX—1943

1 Excess Profits Net Income—Form 1121.....		\$211,074.59
--	--	--------------

Renegotiation Adjustment		(51,192.00)
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Amortization Deduction—Recomputed ...	\$ 12,327.16	
---------------------------------------	--------------	--

Amortization Deduction—Return	5,500.02	(6,827.14)
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Adjustment declared value excess profits tax	782.57	
--	--------	--

1 Excess Profits Net Income—Revised.....		\$153,838.02
--	--	--------------

2 Specific Exemption	\$ 5,000.00	
----------------------------	-------------	--

3 Excess Profits Credit	4,576.37	
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5 Unused Excess Profits Credit (Return)....	2,354.37	11,930.74
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8 Adjusted Excess Profits Net Income.....		\$141,907.28
---	--	--------------

Respondent's Exhibit B—(Continued)

EXCESS PROFITS TAX—1943—(Continued)

9	Tax at 90%	\$127,716.55	
10	Net Income (Item 35 Form 1120) Revised.....		\$153,838.02
11	Dividends Received Credit		
12	Surtax Net Income without Sec. 26(e) Credit.....		\$153,838.02
13	80% Item 12		\$123,070.42
14	Income Tax under Chapter 1.....		3,121.30
15	Excess of 13 over 14.....		\$119,949.12
16	Item 9 or 15 whichever is lesser.....		\$119,949.12
17	Amount Deferred under Sec. 710(a) (5).....		
18	Excess Profits Tax		\$119,949.12
19	Credit for Foreign Taxes		
20	.....		\$119,949.12
21	Credit for Debt Retirement.....		
22	.....		\$119,949.12
23	Amount due to Application of Sec. 734.....		
24	Excess Profits Tax Due.....		\$119,949.12
	Excess Profits Tax Due as above.....	\$119,949.12	
	Less Post War Refund.....	11,994.91	\$107,954.21
	Excess Profits Tax per Return.....	\$168,859.67	
	Credit under Sec. 3806	43,448.84	
	Excess Profits Tax Assessed and Paid.....	\$125,410.83	
	Post War Refund—Bonds Received.....	12,541.08	112,869.75
	Adjustment under Sec. 124(d) (5).....		\$ 4,915.54

Respondent's Exhibit B—(Continued)

HOFFMAN RADIO CORPORATION

ADJUSTMENTS UNDER SEC. 124(d) (5)
YEAR 1944

INCOME TAX—1944

31	Net Income Item 31—Form 1120.....		\$487,632.94
	Amortization Deduction—Recomputed	\$ 24,654.32	
	Amortization Deduction—Return	11,094.48	13,559.84
			<hr/>
31	Net Income for Declared Value Excess Profits Tax.....		\$474,073.10
	Declared Value	\$6,000,000.00	
	10% Declared Value	\$600,000.00	
	Credit for Dividends Received		600,000.00
			<hr/>
	Subject to Tax		None
	Declared Value Excess Profits Tax.....	None	
	Tax Assessed—Return	None	
			<hr/>
	Adjustment under Sec. 124(d) (5)	None	
			<hr/>
31	Net Income Revised as above.....		\$474,073.10
32	Interest on U. S. Obligations.....		
33	Long Term Capital Gains.....		
			<hr/>
34	.....		\$474,073.10
35	Declared Value Excess Profits Tax.....		
			<hr/>
36	Net Income		\$474,073.10
37	Interest on U. S. Obligations.....		
			<hr/>
38	Adjusted Net Income		\$474,073.10
39	Adjusted Excess Profits Net Form 1121.....	\$453,696.73	
40	Credit for Dividends Received.....		453,696.73
			<hr/>
41	Normal Tax Net Income.....		\$ 20,376.37
			<hr/>

Respondent's Exhibit B—(Continued)

INCOME TAX—1944—(Continued)

NORMAL TAX

\$ 5,000.00 at 15%.....	\$ 750.00	
15,000.00 at 17%.....	2,550.00	
376.37 at 19%.....	71.51	\$ 3,371.51

Net Income Item 36.....		\$474,073.10
Adjusted Excess Profits Net.....	\$453,696.73	
Credit for Dividends Received.....		453,696.73
Surtax Net Income		\$ 20,376.37
Surtax at 10%	\$ 2,037.64	
12 Normal Tax	\$ 3,371.51	
Surtax	2,037.64	5,409.15
13 Credit for Foreign Taxes.....		
14 Balance of Income Tax.....		\$ 5,409.15
Income Tax due as above.....		\$ 5,409.15
Taxes previously assessed Return.....		5,401.62
Adjustment under Sec. 124(d) (5).....		\$ 7.53

EXCESS PROFITS TAX—1944

1 Excess Profits Net Income—Form 1121.....		\$487,632.94
Amortization Deduction—Recomputed	\$ 24,654.32	
Amortization Deduction—Return	11,094.48	13,559.84
1 Excess Profits Net Income—Revised.....		\$474,073.10
2 Specific Exemption	\$ 10,000.00	
3 Excess Profits Credit	10,367.37	
5 Unused Excess Profits Credit.....		20,376.37
8 Adjusted Excess Profits Net.....		\$453,696.73

Respondent's Exhibit B—(Continued)

EXCESS PROFITS TAX—1944—(Continued)

9	Tax at 95%	\$431,011.89	
10	Net Income—Item 36—Form 1120.....		\$474,073.10
11	Dividends Received Credit		
12	Surtax Net without Credit under Sec. 26(e).....		\$474,073.10
13	80% Item 12		\$379,258.48
14	Income Tax under Chapter 1.....		5,409.15
15	Excess of 13 over 14.....		\$373,849.33
16	Item 9 or 15 whichever is lesser.....		373,849.33
17	Amount deferred under Sec. 710(a) (5).....		
18	Excess Profits Tax		\$373,849.33
19	Credit for Foreign Taxes.....		
20	.....		\$373,849.33
21	Credit for Debt Retirement.....		
22	.....		\$373,849.33
23	Amount due to Application of Sec. 734.....		
24	Excess Profits Tax Due.....		\$373,849.33
	Excess Profits Tax Due as above.....	\$373,849.33	
	Less Post War Refund.....	37,384.93	336,464.41
	Tax Assessed per Return	\$384,704.73	
	Less Post War Credit.....	38,470.47	346,234.26
	Adjustment Under Sec. 124(d) (5).....		\$ 9,769.86

Respondent's Exhibit B—(Continued)

SU-21 (5-16-42)

Department of the Navy
Office of the Under Secretary
Washington, D. C.

Sept. 7, (Illegible)

Sirs:

There is transmitted herewith conformed copy of—

Certificate of Necessity No. ND-N-6239, dated Sept. 1, (Illegible), the original of which has been signed and issued by the Under Secretary of the Navy pursuant to the provisions of Section 124 of the Internal Revenue Code in response to your application No. 10313.

Respectfully,

/s/ (Illegible).

Enclosure: (1).

Mission Bell Radio Mfg. Co., Inc., 3430 South Hill Street, Los Angeles 7, California.

Date: Sept. 1, 1943

No. ND-N-6239

Navy Department

NECESSITY CERTIFICATE

To the Commissioner of Internal Revenue:

Pursuant to Section 124 of the Internal Revenue Code, particularly subsection (f) thereof, and in

Respondent's Exhibit B—(Continued)

response to the application filed by Mission Bell Radio Mfg. Co., Inc., Los Angeles 7, California.

It Is Hereby Certified that the facilities described in the attached Appendix A (consisting of four pages, one map and one photograph) are necessary in the interest of national defense during the emergency period, up to 100% of the cost attributable to the construction, reconstruction, erection, installation or acquisition thereof, and that the application for this Certificate was filed on July 22, 1943.

By direction of the Secretary of the Navy:

JAMES FORRESTAL,
The Under Secretary of the Navy.

Certified to be a true copy, the original of which has been forwarded to the Commissioner of Internal Revenue, Washington, D. C.

/s/ ROBERT A. IRWIN,
Lt., USNR. Special Assistant to the Under Secretary of the Navy.

APPENDIX A

Name of Corporation: Mission Bell Radio Mfg. Co., Inc.

Address: 3430 So. Hill St., Los Angeles 7, California.

Location of facilities: 3751 So. Hill St., Los Angeles 7, California.

The earliest date of acquisition or beginning of construction, reconstruction, erection, or installation of any of the facilities was June 18th, 1943.

Respondent's Exhibit B—(Continued)

(Note—This application must have been received by either the War Department or the Navy Department in Washington, D. C., before the expiration of 6 months after the above date.)

SUMMARY SHEET

(Applicant must attach hereto additional sheets supplying a description of each facility.)

See page	Actual	Estimated
() Land	\$14,000.00	\$
() Building and Other Construction.....	37,000.00	.....
Equipment:		
() Machine tools .....	.....	.....
() Other metalworking machinery.....	.....	.....
() Power generating and distributing equipment	4,000.00	.....
() Furnaces .....	.....	.....
() Other .....	.....	.....
Other Facilities (specify):		
()
Totals.....		\$
Grand Total of All Facilities, Appendix A.....		\$55,000.00

This Appendix A, including this summary sheet and sheets attached by the applicant supplying a description of each facility, consists of 4 pages and 2 blueprints or maps.

SUGGESTED DESCRIPTIONS
OF FACILITIES

(Do not fill out or return this sheet. Detach and substitute additional sheets giving the identifying details of each facility.)

To guide the applicant in supplying a complete description of each facility sought to be certified the following forms of description are suggested:

Respondent's Exhibit B—(Continued)

Land: Approximately 37,000 sq. ft., 200 ft. by 185 ft., located at 3751 S. Hill St., as indicated by area enclosed by red line on attached blueprint marked “. . . .”, \$14,000.00.

Buildings: Factory building located at 3751 S. Hill St., 100 ft. by 185 ft., approximately 18,500 sq. ft., floor space. Brick and wood construction. One floor, indicated as building “. . . .” on attached blueprint, \$37,000.00.

Machine Tools: Special features or attachments, power installation, \$4,000.00.

Other Facilities: Descriptions of other facilities should conform to the above suggestions insofar as practicable.

Copies of Appendix A, including the Summary Sheet and the sheets attached by the applicant supplying a description of each facility will be attached to any certificate which may be issued. Thus, the descriptions given should be in sufficient detail to assure complete identification of each facility. Facilities which cannot be completely identified, should be described as accurately as possible, stating estimated costs. For the protection of the applicant, complete identification of the facilities should be submitted as an amendment to Appendix A as soon as sufficient identification is available.

A Necessity Certificate is approximately 8½ by 10 inches in size. Therefore, any blueprints or maps which are included as part of Appendix A should, if possible, be made to conform to the size of the certificate. Elevations or working drawings are not needed.

Respondent's Exhibit C—(Continued)

State of California,
County of Los Angeles—ss.

I, H. Jos. Haupt, residing at 3207 Windsor Avenue, Los Angeles, California, as advisor for Mission Bell Radio Mfg. Co., Inc., affirm that pursuant to instructions received, I prepared the attached Corporation Excess Profits Tax Return for the calendar year 1941 showing a net loss of \$15,475.75 and no tax liability on the basis of information furnished by the said Mission Bell Radio Mfg. Co., Inc., without verification by me: that the information set out in the return correctly and fairly reflects the information furnished to or discovered by me during the course of the preparation of the return, and that the said information is true to the best of my knowledge and belief.

/s/ H. JOS. HAUPT.

Subscribed and sworn to before me this 16th day of March, 1942.

/s/ L. M. SHELDON,

Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires October 22, 1945.

State of California,
County of Los Angeles—ss.

I, H. Jos. Haupt, residing at 3207 Windsor Avenue, Los Angeles, California, as advisor for Mission Bell Radio Mfg. Co., Inc., affirm that pur-

Respondent's Exhibit C—(Continued)

suant to instructions received from it, I prepared the attached Corporation Income and Declared Value Excess-Profits Tax Return for the calendar year 1941 showing a net loss of \$15,470.54 and no tax liability, on the basis of information furnished by the said Mission Bell Radio Mfg. Co., Inc., without verification by me; that the information set out in the return correctly and fairly reflects the information furnished to or discovered by me during the course of the preparation of the return, and that the said information is true to the best of my knowledge and belief.

/s/ H. JOS. HAUPT.

Subscribed and sworn to before me this 16th day of March, 1942.

/s/ L. M. SHELDON,

Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires October 22, 1945.

Respondent's Exhibit C—(Continued)

Mission Bell Radio Mfg. Co., Inc.
Los Angeles, California

STATEMENT ATTACHED TO AND MADE A
PART OF CORPORATION INCOME AND
DECLARED VALUE EXCESS - PROFITS
TAX RETURN

For Calendar Year 1941

Item 13—Other Income

Reduction of Reserve for Bad Debts.....	\$ 719.28
Purchase Discounts	92.15
Insurance Dividend	94.85
Bad Debts Recovered.....	5.21
Notes Payable Written Off.....	2,650.00
Credit Balance on Account Receivable Written Off	205.86
	<hr/>
	\$3,767.35

Respondent's Exhibit C—(Continued)

Mission Bell Radio Mfg. Co., Inc.

Los Angeles, California

STATEMENT ATTACHED TO AND MADE A
PART OF CORPORATION INCOME AND
DECLARED VALUE EXCESS - PROFITS
TAX RETURNS

For Calendar Year 1941

Schedule H—Taxes

Excise Tax	\$ 775.75
State Franchise Tax.....	25.00
Capital Stock Tax.....	301.93
Contributions to State Employment Fund	472.09
Federal Excise Tax on Employers of Eight or More	52.46
Federal Old Age Benefits Tax.....	174.86
City License	39.25
Property Taxes	320.81
	<hr/>
	\$2,162.15

Respondent's Exhibit C—(Continued)

Mission Bell Radio Mfg. Co., Inc.
Los Angeles, California

STATEMENT ATTACHED TO AND MADE A
PART OF CORPORATION INCOME AND
DECLARED VALUE EXCESS - PROFITS
TAX RETURN

For Calendar Year 1941

Schedule K

Other Deductions Authorized By Law

Royalties	\$ 894.71
Engineering and Development Expense..	1,000.68
Stationery and Office Supplies.....	205.72
Telephone and Telegrams.....	640.12
Insurance Premiums	203.75
Traveling and Automobile Expense.....	1,422.39
Postage	88.84
General Administrative Expense.....	412.16
Amortization of License Contract Expense	760.92
Sales Commissions	149.20
Advertising	183.66
Cash Discounts and Rebates.....	12.17
Freight and Cartage—Outgoing.....	41.21
Eastern Sales Office Expense.....	350.00
Packing and Shipping Expense.....	13.49
Excess of Sales Tax Liability over Amount Collected .....	.38
	<hr/>
	\$6,379.40

Respondent's Exhibit C—(Continued)

Mission Bell Radio Mfg. Co., Inc.
Los Angeles, California

STATEMENT ATTACHED TO AND MADE A
PART OF CORPORATION INCOME AND
DECLARED VALUE EXCESS - PROFITS
TAX RETURN

For Calendar Year 1941

Schedule A

Cost of Goods Sold, Other Costs Per Books

Freight and Cartage on Materials.....	\$123.39
Heat, Light and Power.....	239.74
Spoilage and Raw Material Repairs.....	82.74
Small Tools	43.04
Miscellaneous Manufacturing Expense.....	137.95
	<hr/>
	\$626.86

Respondent's Exhibit C—(Continued)

Mission Bell Radio Mfg. Co., Inc.

Los Angeles, California

STATEMENT ATTACHED TO AND MADE A
PART OF CORPORATION INCOME AND
DECLARED VALUE EXCESS - PROFITS
TAX RETURN

For Calendar Year 1941

Schedule M—Line 18

Sundry Credits To Earned Surplus

Reserve for Depreciation of Furniture and Fixtures Written Off.....	\$ 535.61
Reserve for Depreciation of Machinery and Equipment Written Off.....	1,740.10
Revaluation of R.C.A. License Contract..	13,695.63
	<hr/>
	\$15,971.34

Respondent's Exhibit D—(Continued)

HERMAN LESLIE HOFFMAN and FRANCES ELAINE HOFFMAN

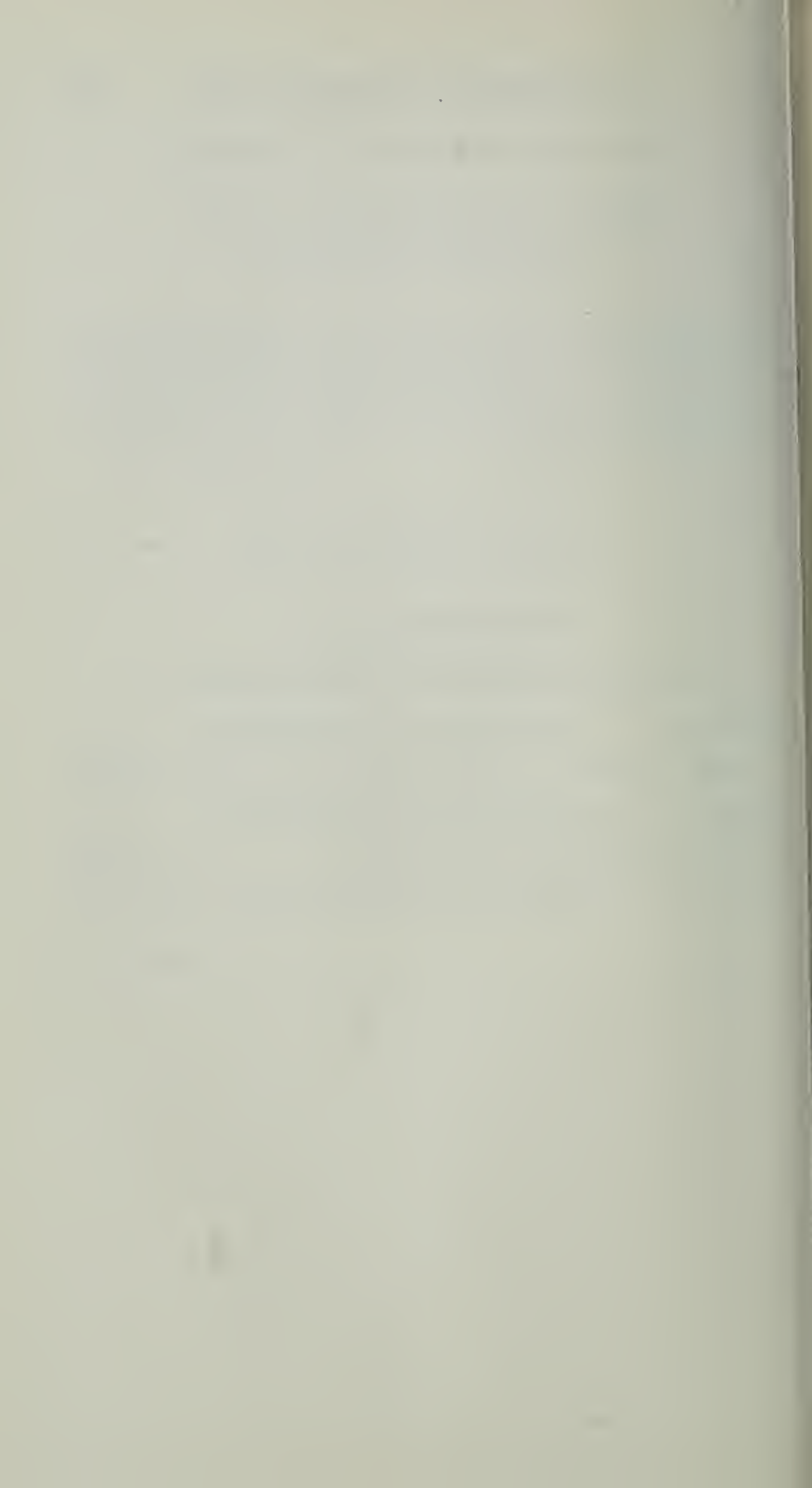
Newport Beach, California

Schedule Attached to and Made a Part of Individual Income Tax
Return for Calendar Year 1941

	Herman Leslie Hoffman	Frances Elaine Hoffman	Total
Item 1—Salaries:			
Peerless Electrical Products Co.....	\$13,616.52	.....	\$13,616.52
The May Company .....	.....	\$ 1,511.54	1,511.54
	<hr/>	<hr/>	<hr/>
	\$13,616.52	\$ 1,511.54	\$15,128.06
	<hr/>	<hr/>	<hr/>
Less—Deductible Expenses:			
Contributions to State Employ- ment Fund	\$ 30.00	\$ 15.12	\$ 45.12
Traveling and Entertainment.....	1,479.50	.....	1,479.50
Telephone and Telegrams.....	65.00	.....	65.00
Automobile Expense:			
31600 miles at 5c....	\$1,580.00		
Less 20% for Per- sonal use	316.00		
	<hr/>		
	1,264.00	.....	1,264.00
Dues and Subscriptions	55.00	.....	55.00
Convention Expense	75.00	.....	75.00
Christmas Gifts (Business Expense)	80.00	.....	80.00
Postage	25.00	.....	25.00
Advertising	200.00	.....	200.00
Salary of Assistant	750.00	.....	750.00
	<hr/>	<hr/>	<hr/>
	\$ 4,023.50	\$ 15.12	\$ 4,038.62
	<hr/>	<hr/>	<hr/>
Net.....	\$ 9,593.02	\$ 1,496.42	\$11,089.44
	<hr/>	<hr/>	<hr/>

Respondent's Exhibit D—(Continued)

	Herman Leslie Hoffman	Frances Elaine Hoffman	Total
Item 11—Contributions Paid:			
Red Cross	\$ 150.00	\$	\$ 150.00
First Presbyterian Church	50.00	50.00	100.00
Community Chest	25.00	.....	25.00
	<hr/>	<hr/>	<hr/>
	\$ 225.00	\$ 50.00	\$ 275.00
	<hr/>	<hr/>	<hr/>
Item 12—Interest:			
Interest on Real Estate Mortgage....	\$ 347.60	\$	\$ 347.60
Interest on Automobile Contract....	182.00	.....	182.00
	<hr/>	<hr/>	<hr/>
	\$ 529.60	\$	\$ 529.60
	<hr/>	<hr/>	<hr/>
Item 13—Taxes:			
Property Taxes	\$ 176.82	\$	\$ 176.82
Automobile Licenses and Taxes.....	42.60	.....	42.60
Amusement Taxes	8.00	.....	8.00
State Income Tax	23.24	40.00	63.24
	<hr/>	<hr/>	<hr/>
	\$ 250.66	\$ 40.00	\$ 290.66
	<hr/>	<hr/>	<hr/>
Item 14—Losses from Casualty:			
Damage to Automobile as the re- sult of accident, not covered by insurance	\$ 125.00	\$	\$ 125.00
	<hr/>	<hr/>	<hr/>
Item 15—Bad Debts:			
Loan uncollectible and Determined worthless in 1941	\$ 30.00	\$	\$ 30.00
	<hr/>	<hr/>	<hr/>



FORM 1040
Treasury Department
Internal Revenue Service

UNITED STATES
INDIVIDUAL INCOME TAX RETURN

1941

(Auditor's Stamp)

OPTIONAL FORM 1040A MAY BE FILED INSTEAD OF THIS FORM IF THE TAXPAYER'S GROSS INCOME DOES NOT EXCEED \$10,000 AND CONSISTS WHOLLY OF SALARIES, WAGES, OTHER COMPENSATION FOR PERSONAL SERVICES, DIVIDENDS, INTEREST, RENT, ANNUITIES, OR ROYALTIES.

For Calendar Year 1941

or fiscal year beginning 1941, and ending 1942

To be filed with the Collector of Internal Revenue for your district not later than the 15th day of the third month following the close of your taxable year

PRINT NAME AND ADDRESS PLAINLY. (See Instruction C)

HERMAN LESLIE HOFFMAN

(Name) (Use given names of both husband and wife, if this is a joint return)

141 Via Zurich

(Street and number, or rural route)

Newport Beach, Orange, California

(Post office)

(County)

(State)

(Do not use this space)
File Code 1325
381090
District 8-Calif
(Cashier's Stamp)
RECEIVED
WITH REMITTANCE
MAR 16 1942
C. O.
First Payment

EXHIBIT D
RECEIVED BY THE U.S. DEPARTMENT OF THE TREASURY
APR 11 1942
EXHIBIT D
RESPONDENT'S

Item and Instruction No.	INCOME	Amount	Deductible Expenses (Attach itemized statement)	(Net)	(State)
1. Salaries and other compensation for personal services.	Schedule Attached	\$	\$	6795.06	
2. Dividends.					
3. Interest on (a) bank deposits, notes, etc., \$; (b) corporation bonds, \$.					
4. Interest on Government obligations, etc.: (a) From line (A), Schedule A, \$; (b) from line (f), Schedule A, \$.					
5. Rents and royalties. (From Schedule B)					
6. Annuities					
ITEMS 7, 8, AND 9, BELOW (AND PAGES 3 AND 4) NEED NOT BE CONSIDERED IF THE TAXPAYER'S GROSS INCOME (OR LOSSES) IN ADDITION TO ITEMS ABOVE, IS FROM A REV. DIVISION.					
7. (a) Net short-term gain from sale or exchange of capital assets. (From Schedule F). (b) Net long-term gain (or loss) from sale or exchange of capital assets. (From Schedule F). (c) Net gain (or loss) from exchange of property other than capital assets. (From Schedule G).					
8. Net profit (or loss) from business or profession. (From Schedule H). (Attach total receipts from 401 Schedule H, \$.)					
9. Income (or loss) from partnerships; fiduciary income; and other income. (From Schedule D).					
10. Total income in items 1 to 9.					6795.06
DEDUCTIONS					
11. Contributions paid. (Explain in Schedule C)	Schedule Attached	\$	225.00		
12. Interest. (Explain in Schedule C)	Schedule Attached		529.60		
13. Taxes. (Explain in Schedule C)	Schedule Attached		250.66		
14. Losses from fire, storm, shipwreck, or other casualty, or theft. (Explain in Schedule C)	Schedule Attached		125.00		
15. Bad debts. (Explain in Schedule C)	Schedule Attached		30.00		
16. Other deductions authorized by law. (Explain in Schedule C)					
17. Total deductions in items 11 to 16.					1160.26
18. Net income (item 10 minus item 17)					5634.80

COMPUTATION OF TAX	
19. Net income (item 18 above)	\$ 5634.80
20. Less: Personal exemption. (From Schedule D-1)	\$ 1500.00
21. Credit for dependents. (From Schedule D-2)	233.35
22. Balance (surtax net income)	\$ 3901.47
23. Less: Item 4 (a) above	\$
24. Earned income credit. (From Schedule E-1 or E-2)	563.48
25. Balance subject to normal tax	\$ 3337.99
26. Normal tax (4% of item 25)	\$ 133.52
27. Surtax on item 22. (See Instruction 27)	291.11
28. Total (item 26 plus item 27)	\$ 424.63
29. Total tax (item 28 or line 16, Schedule F)	\$ 424.63
30. Less: Income tax paid at source	\$
31. Income tax paid to a foreign country or U.S. possession. (Attach Form 1116)	\$
32. Balance of tax (item 29 minus items 30 and 31)	\$ 424.63

I/we swear (or affirm) that this return (including any accompanying schedules and statements) has been examined by me and to the best of my/our knowledge and belief is a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued under authority thereof.

Subscribed and sworn to by Herman Leslie Hoffman

Herman Leslie Hoffman
(Signature) (See Instruction E)

before me this 16th day of March, 1942

NOTARY PUBLIC IN AND FOR THE COUNTY OF

(Signature and title of officer administering oath)
A return made by an agent must be accompanied by power of attorney. (See Instruction E)

If this is a joint return (and made by agent), it must be signed by both husband and wife. It must be sworn to before a proper officer by the agent preparing the return.

(IF THIS RETURN WAS PREPARED FOR YOU BY SOME OTHER PERSON, THE AFFIDAVIT ON PAGE 4 MUST BE EXECUTED)

My Commission Expires October 22, 1945



Schedule A.—INTEREST ON GOVERNMENT OBLIGATIONS, ETC. (See Instruction G)

11

1. Obligations or securities

2. Amount owned at end of year including your proportionate share of such obligations held by estates, trusts, partnerships, or common trust funds	3. Interest received or accrued during the year	4. Amount of principal interest on which is exempt from taxation	5. Interest on amount exempt of "simple and dividends not subject to surtax on"
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions.		All	XXXXXXXXXX
(b) Obligations issued prior to March 1, 1941, under Federal Farm Loan Act, or under such Act as amended.		All	XXXXXXXXXX
(c) Obligations of United States issued on or before September 1, 1917.		All	XXXXXXXXXX
(d) Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness issued prior to March 1, 1941.		All	XXXXXXXXXX
(e) United States Savings Bonds and Treasury Bonds issued prior to March 1, 1941.		All	XXXXXXXXXX
(f) Obligations of instrumentalities of the United States (other than obligations to be reported in (b) above) issued prior to March 1, 1941.		\$5,000	\$
(g) Dividends on share accounts in Federal savings and loan associations.		None	
(h) Total (enter as item 4 (d), page 1).	XXXXXXXXXXXX	XXXXXXXXXX	XXXX
(i) Obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof (enter amount of interest as item 4 (d), page 1).		Amount owned at end of year	Interest received or accrued during the year (subject to normal tax and surtax)

Schedule B.—INCOME FROM RENTS AND ROYALTIES. (See Instruction 5)

1. Kind of property	2. Amount	3. Depreciation or depletion (attach schedule)	4. Repairs (explain below)	5. Other expenses (itemize below)	6. Net profit (column 2 minus sum of columns 3, 4, and 5) (enter as item 5, page 1)
	\$	\$	\$	\$	\$

Explanation of deductions claimed in columns 4 and 5.

Schedule C.—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 11, 12, 13, 14, 15, AND 16

1. Item No.	2. Explanation	3. Amount	1. Item No. (Continued)	2. Explanation (Continued)	3. Amount (Continued)
	SCHEDULE ATTACHED	\$			\$

Schedule D.—EXPLANATION OF CREDITS CLAIMED IN ITEMS 20 AND 21. (See Instructions 20 and 21)

(1) Personal Exemption			(2) Credit for Dependents		
Status	Number of months during the year in each status	Credit claimed	Name of dependent and relationship	Number of months during the year	Credit claimed
Single, or married and not living with husband or wife, and not head of family.		\$	Mrs. F.A. Hoffman	Under 18 years old	
Married and living with husband or wife.	7	875.00	Mother	18 years or over	
Head of family (explain below)	5	625.00			233.33

Reason for support if 18 years or over: Mother physically defective

Schedule E.—COMPUTATION OF EARNED INCOME CREDIT. (See Instruction 24)

(1) If your net income is \$3,000 or less, use only this part of schedule		(2) If your net income is more than \$3,000, use only this part of schedule	
Net income (item 18, page 1)	\$	Earned net income (not more than \$14,000)	\$ 6795.06
Earned income credit (10% of net income, above)		Net income (item 18, page 1)	5634.80
		Earned income credit (10% of earned net income or 10% of net income, above, whichever amount is smaller, but do not enter less than \$300)	563.48

QUESTIONS

State your principal occupation or profession: Manufacturers Representative

Name and address of employer: Pearless Electrical Products Co Los Angeles Calif.

Did you file a return for any prior year? Yes If so, what was the latest year? 1940 To which Collector's office was it sent? Sixth California

If separate return was made for the current year, state:

(a) Name of husband or wife: Francis Elaine Hoffman

(b) Personal exemption, if any, claimed thereon: 2

(c) Collector's office to which it was sent: Sixth California

Check whether this return was prepared on the cash or accrual basis.

If return on cash basis, do you elect, under section 42, to include as income:

7. Did you receive during the taxable year any nontaxable income other than interest reported in Schedule A (see Instruction G)? NO If so, attach schedule showing source, nature, and amount of such income.

8. Did you at any time during your taxable year own directly or indirectly any stock of a foreign corporation or a personal holding company as defined by section 501 of the Internal Revenue Code? NO If so, attach statement required by Instruction J.

B.2

Respondent's Exhibit D—(Continued)

HERMAN LESLIE HOFFMAN and FRANCES ELAINE HOFFMAN
Newport Beach, California

Schedule Attached to and Made a Part of Individual Income Tax
Return for Calendar Year 1941

SUMMARY

Item No.	Income	Total	Reported by	
			Husband	Wife
1	Salaries	\$11,089.44	\$ 6,795.06	\$ 4,294.38
	Deductions			
11	Contributions Paid	\$ 275.00	\$ 225.00	\$ 50.00
12	Interest	529.60	529.60	.....
13	Taxes	290.66	250.66	40.00
14	Losses from Casualty.....	125.00	125.00	.....
15	Bad Debts	30.00	30.00	.....
17	Total Deductions	\$ 1,250.26	\$ 1,160.26	\$ 90.00
18	Net Income	\$ 9,839.18	\$ 5,634.80	\$ 4,204.38

Respondent's Exhibit D—(Continued)

HERMAN LESLIE HOFFMAN and FRANCES ELAINE HOFFMAN

Newport Beach, California

Schedule Attached to and Made a Part of Individual Income Tax
Return for Calendar Year 1941

	Herman Leslie Hoffman	Frances Elaine Hoffman	Total
Item 1—Salaries:			
Peerless Electrical Products Co.....	\$13,616.52	.....	\$13,616.52
The May Company .....	.....	\$ 1,511.54	1,511.54
	<hr/>	<hr/>	<hr/>
	\$13,616.52	\$ 1,511.54	\$15,128.06
	<hr/>	<hr/>	<hr/>
Less—Deductible Expenses:			
Contributions to State Employ- ment Fund	\$ 30.00	\$ 15.12	\$ 45.12
Traveling and Entertainment.....	1,479.50	.....	1,479.50
Telephone and Telegrams.....	65.00	.....	65.00
Automobile Expense:			
31600 miles at 5c....	\$1,580.00		
Less 20% for Per- sonal use	316.00	1,264.00	1,264.00
	<hr/>		
Dues and Subscriptions	55.00	.....	55.00
Convention Expense	75.00	.....	75.00
Christmas Gifts (Business Expense)	80.00	.....	80.00
Postage	25.00	.....	25.00
Advertising	200.00	.....	200.00
Salary of Assistant	750.00	.....	750.00
	<hr/>	<hr/>	<hr/>
	\$ 4,023.50	\$ 15.12	\$ 4,038.62
	<hr/>	<hr/>	<hr/>
Net.....	\$ 9,593.02	\$ 1,496.42	\$11,089.44
	<hr/>	<hr/>	<hr/>

Respondent's Exhibit D—(Continued)

	Herman Leslie Hoffman	Frances Elaine Hoffman	Total
Item 11—Contributions Paid:			
Red Cross	\$ 150.00	\$	\$ 150.00
First Presbyterian Church	50.00	50.00	100.00
Community Chest	25.00	.....	25.00
	<hr/>	<hr/>	<hr/>
	\$ 225.00	\$ 50.00	\$ 275.00
Item 12—Interest:			
Interest on Real Estate Mortgage....	\$ 347.60	\$	\$ 347.60
Interest on Automobile Contract....	182.00	.....	182.00
	<hr/>	<hr/>	<hr/>
	\$ 529.60	\$	\$ 529.60
Item 13—Taxes:			
Property Taxes	\$ 176.82	\$	\$ 176.82
Automobile Licenses and Taxes.....	42.60	.....	42.60
Amusement Taxes	8.00	.....	8.00
State Income Tax	23.24	40.00	63.24
	<hr/>	<hr/>	<hr/>
	\$ 250.66	\$ 40.00	\$ 290.66
Item 14—Losses from Casualty:			
Damage to Automobile as the re- sult of accident, not covered by insurance	\$ 125.00	\$	\$ 125.00
Item 15—Bad Debts:			
Loan uncollectible and Determined worthless in 1941	\$ 30.00	\$	\$ 30.00

Respondent's Exhibit D—(Continued)

State of California,
County of Los Angeles—ss.

I, H. Jos. Haupt, residing at 3207 Windsor Avenue, Los Angeles, California, as advisor for Herman Leslie Hoffman, affirm that pursuant to instructions I received from him, I prepared the attached individual return of income for the calendar year 1941 showing a net income of \$5,634.80 and a tax liability of \$424.65 on the basis of information furnished by the said Herman Leslie Hoffman, without verification by me: that the information set out in the return correctly and fairly reflects the information furnished to or discovered by me during the course of the preparation of the return, and that the said information is true to the best of my knowledge and belief.

/s/ H. JOS. HAUPT.

Subscribed and sworn to before me this 16th day of March, 1942.

/s/ L. M. SHELDON,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires October 22, 1945.

RESPONDENT'S EXHIBIT E

[Stamp]: Revenue Agent in Charge, Los Angeles Division. Received Dec. 20, 1945.

STATEMENT OF PROTEST OF H. LESLIE
HOFFMAN AND ELAINE S. HOFFMAN,
2245 EL MOLINO PLACE, SAN MARINO,
CALIFORNIA

Calendar Year 1943

Los Angeles, California, Dec. 18, 1945

Mr. George D. Martin
Internal Revenue Agent in Charge
Los Angeles, California

Attention: Internal Revenue Agent
J. F. Fraser.

Dear Sir:

Reference is made to the office audit made by your office with respect to the income tax return for the calendar year 1943 filed by Mr. H. Leslie Hoffman and his wife, Elaine S. Hoffman, and in which you propose a deficiency tax in the respective amounts of \$698.81 and \$751.26.

Two adjustments are proposed by the office audit. It is proposed to disallow a loss of \$500.00 claimed with respect to the sale of a boat and to disallow as a deduction the payment in the sum of \$1,500.00 made to P. L. Fleming.

Taxpayers sold the boat during the year 1943 which had cost them the sum of \$1,350.00 for the sum of \$750.00 and thereby sustained a loss in the

Respondent's Exhibit E—(Continued)

sum of \$600.00, and they took sustained appreciation in the sum of \$100.00 and claimed a net loss in the sum of \$500.00, reporting \$250.00 loss on each tax return.

When the taxpayer H. Leslie Hoffman purchased this boat prior to the year 1943 he was in the employ of the Peerless Electrical Products Company and Lumador Electrical Manufacturing Company. While being engaged in such employment he was not paid a salary but was paid compensation entirely upon a commission basis. It was necessary in order that the taxpayer might earn the commissions which he did that he contact the trade and he used the boat in question for the purpose of making business friends and contacts which in turn would inure to his benefit and result in the purchase of goods from the two corporations by whom he was employed. The boat was not used for his own personal pleasure, comfort and enjoyment but was used as an adjunct to his business of soliciting sales for the two corporations by whom he was employed, and the boat was therefore directly connected with his business. The Revenue Agent is in error in stating that the taxpayer only received a salary. He did not receive a salary but as above explained, worked entirely upon a commission basis.

In December of 1941 the taxpayer H. Leslie Hoffman made a business agreement whereby he and two others would purchase the outstanding stock of the Mission Bell Manufacturing Company,

Respondent's Exhibit E—(Continued)

Inc., and whereby he would also accept employment from Mission Bell Radio Manufacturing Company, Inc., on a percentage of the sales made by said corporation. Mr. P. L. Fleming was connected with the corporation at the time Mr. Hoffman became interested in its possibilities and Mr. Hoffman agreed with Mr. Fleming that if he would acquaint him with the radio manufacturing business and lend him aid and assistance in the reorganization of the company he would pay to Mr. Fleming the sum of \$1,500.00. The amount paid to Mr. Fleming was not an obligation of the corporation but was an entirely independent transaction between H. Leslie Hoffman and P. L. Fleming. The amount paid by Mr. Hoffman to Mr. Fleming made it possible for Mr. Hoffman to reorganize the corporation, and his successful operation of the company made it possible for him to report the very substantial earnings which he received in the year 1943. The amount paid Mr. Fleming bore a direct relationship to the business of the taxpayer and the direct benefit of such an agreement with Mr. Fleming is evidenced by the substantial income reported by the taxpayer and his wife on their returns for the year 1943.

Wherefore it is respectfully submitted that the Agent was in error in proposing the two disallowances here in question.

Respectfully submitted,

/s/ H. LESLIE HOFFMAN.

/s/ ELAINE S. HOFFMAN.

Respondent's Exhibit E—(Continued)

State of California,
County of Los Angeles—ss.

H. Leslie Hoffman and Elaine S. Hoffman being duly sworn, state they have read the foregoing protest and are familiar with the statements contained therein and that the statements contained therein are true, except those stated to be upon information and belief and those they believe to be true.

/s/ H. LESLIE HOFFMAN.

/s/ ELAINE S. HOFFMAN.

Subscribed and sworn to before me this 19th day of December, 1945.

/s/ R. A. YARCHO,
Notary Public.

My Commission Expires March 21, 1946.

CERTIFICATE

I hereby certify that the foregoing protest was prepared by me for and on behalf of taxpayer; that the facts recited in said protest are the exact facts as given to me by the taxpayer and to the best of my knowledge and belief are true and correct.

/s/ JOHN B. MILLIKEN,
Attorney at Law.

RESPONDENT'S EXHIBIT F

War Production Sales

Gilfillan Bros., Inc.

Year ended May 31, 1943

Adel Precision Products Corp.
Bakewell Manufacturing Co.
Bechtel-McCone-Parsons Corp.
Bell Aircraft Corp., Buffalo.
Bell Aircraft Corp., Marietta.
Bendix Aviation, Ltd.
Boeing Aircraft Co., Renton.
Boeing Aircraft Co., Seattle.
Boeing Airplane Co., Wichita.
Buhl Stamping Co.
Consolidated Aircraft Corp., Fort Worth.
Consolidated Aircraft Corp., San Diego.
Curtiss-Wright Corp., Columbus.
Curtiss-Wright Corp., St. Louis.
Davis Precision Machine Shop.
John Deere Harvester Works.
Doak Aircraft Co., Inc.
Douglas Aircraft Co., Inc., Chicago.
Douglas Aircraft Co., Inc., El Segundo.
Douglas Aircraft Co., Inc., Long Beach.
Douglas Aircraft Co., Inc., Oklahoma City.
Douglas Aircraft Co., Inc., Santa Monica.
Douglas Aircraft Co., Inc., Tulsa.
General Motors Corp., Cleveland.
General Motors Corp., Memphis.

Respondent's Exhibit F—(Continued)

Ford Motor Co.

Hartwell Aviation Supply Co.

Houde Engineering Division of Houdaille, Hershey Corp.

Lockheed Aircraft Corp.

The Glenn L. Martin Co., Baltimore.

The Glenn L. Martin Nebraska Co.

Monarch Tool and Instrument Co.

The Murray Corporation of America.

National Supply Co.

North American Aviation, Inc., Dallas.

North American Aviation, Inc., Inglewood.

Northrop Aircraft, Inc.

Precision Aeronautical Parts Mfg. Co.

Solar Aircraft Co.

U. S. Army Air Corps.

U. S. Army Signal Corps.

U. S. Navy.

University of California.

Vega Aircraft Corp.

Waldorf-Hendrickson, Inc.

RESPONDENT'S EXHIBIT G
 Gilfillan Bros, Inc.—Profit and Loss Statement
 Year Ended May 31, 1943

	Before Renegotiation	Renegotiation	Net
Net sales	\$ 3,695,822.57	\$ 200,000.00	\$ 3,495,822.57
Cost of products sold.....	2,792,274.67	.....	2,792,274.67
Gross Profit.....	\$ 903,547.90	\$ 200,000.00	\$ 703,547.90
Expenses:			
Shipping and receiving.....	\$ 62,100.77		\$ 62,100.77
General and administrative.....	313,030.33	7,785.00	305,245.33
Total Expenses.....	\$ 375,131.10	\$ 7,785.00	\$ 367,346.10
Operating Profit.....	\$ 528,416.80	\$ 192,215.00	\$ 336,201.80
Other income:			
Cash discounts	\$ 7,421.66		\$ 7,421.66
Sale of scrap materials.....	6,870.72		6,870.72
Profit on sale of capital assets.....	1,115.57		1,115.57
Sundry.....	2,727.91		2,727.91
	\$ 546,552.66	\$ 192,215.00	\$ 354,337.66

Respondent's Exhibit G—(Continued)

	Before	Renegotiation	Net
Other deductions:			
Cash discounts.....	\$ 16,533.29		\$ 16,533.29
Interest.....	6,005.87		6,005.87
Loss on sale of securities.....	19,000.00		19,000.00
Commercial sales and service—net.....	5,513.39		5,513.39
Sundry.....	335.47		335.47
	<u>\$ 47,388.02</u>	.....	<u>\$ 47,388.02</u>
Profit Before Taxes on Income.....	\$ 499,164.64	\$ 192,215.00	\$ 306,949.64
Federal taxes on income estimated:			
Normal income tax and surtax.....	\$ 20,102.43	\$ 1,469.85	\$ 21,572.28
Excess profits tax.....	370,174.23	150,750.29	219,423.94
	<u>\$ 390,276.66</u>	<u>\$ 149,280.44</u>	<u>\$ 240,996.22</u>
Less post war refund of excess profits tax.....	\$ 15,057.42	\$ 15,057.42	.....
	<u>\$ 375,219.24</u>	<u>\$ 134,223.02</u>	<u>\$ 240,996.22</u>
Net Profit.....	\$ 123,945.40	\$ 57,991.98	\$ 65,953.42

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

The parties to this proceeding, through their respective counsel of record, hereby stipulate that the following facts are true and may be found as facts by the Court, subject to the right of either party to present other items of proof, either related or unrelated to the facts herein stated, but not inconsistent herewith, and subject to any objection on the grounds of irrelevancy or immateriality.

I.

The petitioner is a California corporation whose principal office is now located at 3761 South Hill Street, Los Angeles 7, California. The former location of its [387] principal office was 3430 South Hill Street, Los Angeles 7, California. The returns for the calendar taxable year 1943, the year involved in this proceeding, were filed with the Collector of the Sixth District of California.

II.

The petitioner was incorporated in California on June 30, 1932, under the name of Mission Bell Radio Mfg. Co., Inc.; but, without otherwise altering the continuity of its corporate existence, its name was changed to Hoffman Radio Corporation in 1943.

III.

Attached hereto as Exhibit 1, and made a part hereof, is a complete and correct copy of the War Production Board Supplementary General Limitation Order L-44-a issued March 7, 1942, which fur-

ther restricted and finally prohibited the commercial manufacture of radio receivers and phonographs.

IV.

During the years 1942 and 1943, the petitioner was engaged in the business of manufacturing radio and electronic equipment. Attached hereto as Exhibit 2, and made a part hereof, is a breakdown of the sales of the petitioner, for the year 1942, between commercial sales, sales under prime contracts with the armed forces of the [388] United States and other governmental agencies, and sales under subcontracts to businesses working on governmental orders. Attached hereto as Exhibit 3, and made a part hereof, is a similar breakdown of the sales of the petitioner, for the year 1943.

V.

Attached hereto as Exhibit 4, and made a part hereof, is a complete and correct copy of an Agreement dated December 1, 1941, between H. L. Hoffman and H. G. Schmieter concerning the purchase by Hoffman from Schmieter of 110 shares of the stock of petitioner.

VI.

Attached hereto as Exhibit 5, and made a part hereof, is a complete and correct copy of an Agreement dated December 4, 1941, between H. L. Hoffman and Franklyn Warner and Helen E. Warner concerning the purchase by Hoffman from the Warners of 193 shares of the stock of petitioner.

VII.

Attached hereto as Exhibit 6, and made a part

hereof, is a complete and correct copy of an Agreement dated December 4, 1941, between H. L. Hoffman and P. L. Fleming concerning the purchase by Hoffman from Fleming of 110 shares of the stock of the petitioner. [389]

VIII.

Attached hereto as Exhibit 7, and made a part hereof, is a complete and correct copy of an Agreement dated December 9, 1941, between H. L. Hoffman, G. Gifford Davidge, and Walter D. Douglas concerning the contract rights and the shares acquired by Hoffman pursuant to the three agreements set forth in Exhibits 4, 5, and 6 attached.

IX.

For the years 1941 to 1943, inclusive, the record of stock ownership of the petitioner was a set forth in Exhibit 8 attached, which is made a part hereof.

X.

Attached hereto as Exhibits 9, 10 and 11, and made a part hereof, are the petitioner's comparative balance sheets for the period January 1, 1941, to December 31, 1943, inclusive; the reconciliation of surplus for the period December 31, 1939, to December 31, 1943, inclusive; and the comparative profit and loss statements for the years 1940 to 1943, inclusive.

XI.

Attached hereto as Exhibits 12 and 13, and made a part hereof, are complete and correct copies of the resolutions of the Board of Directors of petitioner concerning the compensation of H. L. Hoffman and Walter S. Harmon. [390]

XII.

Attached hereto as Exhibits 14, 15, and 16, and made a part hereof, are complete and correct copies of the compensation contracts entered into between the petitioner and H. L. Hoffman and Walter S. Harmon.

XIII.

Attached hereto as Exhibits 17 and 18, and made a part hereof, are complete and correct copies of the portions of the records of the petitioner relating to the accrual of the H. L. Hoffman and Walter S. Harmon payments. The sums shown on the exhibits are after deducting income tax withholding and social security taxes. All such sums were paid by the petitioner during 1943, except the sums of \$12,089.24, in the case of Hoffman, and \$4,207.29, in the case of Harmon, which were paid on or before February 2, 1944.

XIV.

H. L. Hoffman and his wife, and Walter S. Harmon and his wife, reported their incomes for the year 1943 on the cash receipts and disbursements basis, and they reported their compensation income as community property income. For the year 1943, H. L. Hoffman and his wife reported compensation income received from the petitioner in the total amount of \$63,613.20; and for the year 1943 Walter S. Harmon and his wife reported compensation income [391] received from the petitioner in the total amount of \$22,171.08.

XV.

Submitted concurrently herewith are Exhibits A and B, which are complete and correct copies of

the Federal tax return Forms 1120 and 1121 filed by the petitioner for the year 1943.

XVI.

Attached hereto as Exhibit 19, and made a part hereof, is a schedule showing the payments made by petitioner to its officers for the years 1942 and 1943.

XVII.

Attached hereto as Exhibit 20, and made a part hereof, is a schedule showing the payments made by petitioner to its officers and employees, other than employees compensated on an hourly basis, for the year 1943.

XVIII.

The highest number of employees employed by petitioner in the years 1941 to date were as follows:

Year	Number of Employees
1941	3
1942	107
1943	297
1944	351
1945	462
1946	765
1947 to date.....	546

XIX.

Attached hereto as Exhibit 21, and made a part hereof, is a schedule showing, for the years 1932 to 1941, the petitioner's gross income, net income, dividends paid, payments to officers, sales commissions (to the extent of available records), and payment to engineer (to the extent of available rec-

ords). Attached hereto as Exhibit 22, and made a part hereof, is a schedule showing similar data for the years 1942 and 1943. In both exhibits "Net Income" is computed before the deduction of federal taxes.

Dated: December 11, 1947.

Respectfully submitted,

/s/ JOHN B. MILLIKEN,
/s/ HARRISON HARKINS,
Counsel for Petitioner.

/s/ CHARLES OLIPHANT, ECC,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent. [393]

[Endorsed]: T.C.U.S. Filed Dec. 11, 1947.

EXHIBIT No. 1

Title 32—National Defense

Chapter IX—War Production Board

Subchapter B—Division of Industry Operations

Part 1077—Radio Receivers and Phonographs

Supplementary General Limitation Order L-44-a

Further Restricting and Finally Prohibiting the

Production of Radio Receivers and Phonographs

It Is Hereby Ordered That:

In accordance with the provisions of 1077.1 (General Limitation Order L-44), which the following Order supplements,

It Is Hereby Ordered That:

1077.2 Supplementary General Limitation Order.

(a) Definitions. For the purposes of this Order,

(1) "Manufacturer" means any person who puts into production any set.

(2) All the definitions contained in paragraph (a) of Limitation Order L-44 shall apply to this Order.

(b) Prohibition of Production of Sets after April 22, 1942. Effective April 23, 1942, no Manufacturer shall put into production any sets.

(c) Limit on Use of Materials. From the effective date of this Order, no Manufacturer shall use in any manner in the production of sets more than \$500 worth of materials and parts obtained under contracts or orders executed or placed after February 11, 1942, except that nothing in this paragraph shall impose any limit or restrictions on the use of wooden cabinets or materials for making such cabinets.

(d) Appeal. Any Manufacturer who considers that relief from the specific provisions of this Order will affirmatively facilitate his program of conversion from civilian to war work, may apply for relief by addressing a letter to the War Production Board, Washington, D. C. Ref: L-44-a, setting forth the pertinent facts and the reason why he considers he is entitled to relief. The Director of Industry Operations may thereupon take such action as he deems appropriate.

(e) Effective Date. This Order shall take effect on the date of its issuance, and shall continue in effect until revoked.

Issued this 7th day of March, 1942.

/s/ J. S. KNOWLSON,
Director of Industry
Operations.

EXHIBIT No. 2

1942 Sales

	Sub-contractor on		Government Orders of—		Government	
	Commercial	Government Orders of—	Bendix	Kingston	Signal Supply	Experimental
	Radios	Aviation	Products	Job No. 6	Office	Job No. 6
		\$	\$	\$	\$	\$
January	1,798.87					
February	15,500.07					
March	5,079.64	1,488.80				
April	46,075.94	935.46				
May	26,788.06	8,451.52				
June	24,421.64	18,952.24				
July	230.94	16,421.88		178.92		
August	2,707.15	23,399.09				336.28
September	196.72	22,541.37				
October		25,411.60	7,854.00			
November		35,604.12	5,915.28			
December		55,812.00	5,856.48			
Total	\$122,799.03	\$209,018.08	\$ 19,625.76	\$178.92	\$336.28	
Discount allowed	984.39					
Sale of Scrap		976.94				
Totals	\$121,814.64		\$229,610.78		\$515.20	
Percent of Total (\$351,950.62)	34.61%		65.24%		0.15%	

EXHIBIT No. 3

1943 Sales

Job No.	Commercial	Sub-Contractor	
		on Govt. Orders	Prime Govern- ment Orders
1 Bendix.....	\$	\$111,821.96	\$
2 Bendix.....	.....	362,976.70	.....
3 Bendix.....	.....	11,297.66	.....
5 Miscellaneous.....	.....	8,766.46	511.00
6 Sears, Roebuck & Misc.....	720.58	.....	.....
8 Kingston.....	.....	14,885.20	.....
9 Kingston.....	.....	65,234.40	.....
E Kingston.....	.....	17,454.78	.....
0 Philadelphia Signal Corps.....	.....	.....	232,554.57
2 Philadelphia Signal Corps.....	.....	.....	194,555.20
4 Marine Radio Service.....	.....	5,390.00	.....
5 Navy, Bureau Supplies & Acctsp .....	.....	.....	733,474.70
6 Wright Field Signal Corps.....	.....	.....	44,585.84
8 Navy & OSS.....	.....	.....	12,350.00
9 Office of Scientific Research.....	.....	.....	19,853.94
	<hr/>	<hr/>	<hr/>
	\$720.58	\$597,827.16	\$ 1,237,885.25
Total.....	\$1,836,432.99		
Percent of Total	100%	00.04%	32.55%
			67.41%

EXHIBIT No. 4

AGREEMENT

This Agreement made and entered into this 1st day of December, 1941, by and between H. L. Hoffman, First Party, sometimes herein designated as "Hoffman," and H. G. Schmieter, Second Party, sometimes herein designated as "Schmieter,"

Witnesseth:

Whereas, Mission Bell Radio Mfg. Co., Inc., hereinafter referred to as "Mission Bell," is a corporation having an authorized capital of Five Hundred (500) shares of common stock, of the par

Exhibit No. 4—(Continued)

value of One Hundred Dollars (\$100.00) per share, and there are issued and outstanding Four Hundred Thirteen (413) shares of said stock, of which Schmieter is the owner and in possession of One Hundred Ten (110) shares; and

Whereas, the Board of Directors of said corporation, according to the Minutes of said corporation, consists of the following:

P. L. Fleming, Director, President and Chairman of the Board;

H. G. Schmieter, Director, Vice-President and Treasurer;

M. Penny, Director and Secretary;

but the said Schmieter asserts and declares that his election and appointment in the above capacities, were not consented to or acquiesced in by him, nor has he ever accepted such election or appointment, or served in such capacity since his appointment when last made; and

Whereas, Hoffman is desirous of purchasing from Schmieter the One Hundred Ten (110) shares of said stock in said Mission Bell;

Whereas, Schmieter understands and believes said Mission Bell Co. is in financial difficulties and will be unable to continue in business unless additional funds are secured by [397] borrowing or otherwise;

Now, Therefore, for and in consideration of the premises and other good and valuable consideration, the parties hereto do agree as follows, to-wit:

Schmieter agrees to sell to Hoffman, and Hoffman agrees to purchase from Schmieter, the said

Exhibit No. 4—(Continued)

One Hundred Ten (110) shares of stock in Mission Bell, held and owned by Schmieter, at and for the total sum of Four Thousand One Hundred Eighty Dollars (\$4180.00), payable in the following manner, and subject to the following terms and conditions, to-wit:

Upon the execution of this agreement, Hoffman agrees to pay unto Schmieter the sum of One Hundred Dollars (\$100.00), and thereafter, each and every month, a sum equal to One per cent (1%) of the gross sales of all merchandise of Mission Bell, said monthly payments to be made on or before the 10th day of each and every month, beginning on the 10th day of January, 1942,—the amount of each payment to be based upon the gross sales for the preceding calendar month.

The unpaid balance shall bear interest at the rate of Three per cent (3%) per annum, payable monthly, and such interest payments shall be in addition to the principal payments above provided for, but in any event Hoffman agrees to pay a minimum sum of One Hundred Dollars (\$100.00) per month, even though One per cent (1%) of the gross sales for the preceding month do not equal that amount.

It is further understood and agreed that in any event the balance of the purchase price shall become due and payable and shall be paid by Hoffman to Schmieter on or before Thirty-six (36) months from the date the first payment is to be made as herein provided.

Schmieter agrees, immediately upon the pay-

Exhibit No. 4—(Continued)

ment of the first One Hundred Dollars (\$100.00) hereinabove provided for, [398] to properly endorse and deliver and cause to be transferred to Hoffman on the books of the corporation, the said One Hundred Ten (110) shares of Mission Bell stock, and Hoffman agrees to forthwith cause the new certificates issued in lieu of those transferred to the said Hoffman, to be endorsed to Schmieter as pledgee and delivered to Schmieter as collateral security for the performance by Hoffman of the terms and conditions of this agreement, and Hoffman hereby agrees that in the event of the default in the payment by Hoffman, of the sums to be paid to Schmieter as herein provided, or any installment thereof, when due, that the said Schmieter shall be and he is hereby invested irrevocably with full authority to retain, use, transfer, hypothecate, sell or convey the said collateral shares of stock, or cause the same to be done at public or private sale, with or without advertisement, notice or demand of any sort, and at such place and upon such terms as the said Schmieter, his successors or assigns deem best, and the said Schmieter, or his successors or assigns, shall be and they and each of them are hereby authorized to purchase said collateral stock when sold, for his, their or its protection, and the proceeds of such sale, transfer or hypothecation shall be applied to the payment of the obligations herein provided for, together with all protests, damages, interest, costs, fees and charges due under this agreement, or incurred by reason of such non-

Exhibit No. 4—(Continued)

payment when due, or any installment or installments thereof as in this agreement provided, or in execution of the power herein granted.

The surplus, after the payment of said obligations, together with the charges above stated, if any, shall be paid to Hoffman, but in the event the proceeds of the above sale or sales be not sufficient to pay said obligations, then Schmieter [399] waives any right to any deficiency under the terms and conditions of this agreement, and Hoffman shall not be liable for any such deficiency to the said Schmieter, his successors or assigns. In any and every event and whether said stock be retained, sold or otherwise disposed of, Hoffman shall have no personal obligation under this agreement except for the payment of the \$100.00 first to be paid and for any breach of this contract by Hoffman, Schmieter shall have recourse against, and only against said stock pledged as above provided.

Hoffman shall in any event, at all times when he is not in default under the terms and conditions of this agreement, be entitled to receive, have and take all dividends which may be properly declared upon said stock; provided that in the event he is in default, his right to such dividends shall ipso facto cease and terminate.

In the event Hoffman shall pay in full to the said Schmieter, at the times and in the manner herein provided for, all sums due the said Schmieter as herein provided, then Schmieter shall, upon demand, re-deliver said stock to Hoffman, and shall

Exhibit No. 4—(Continued)

execute and perform all other acts necessary to be performed by him for the re-transfer thereof to Hoffman.

Hoffman shall at all times while said stock is hypothecated with Schmieter, and when Hoffman is not in default under the terms and conditions hereof, be entitled to the absolute right to vote such stock.

Schmieter further agrees, upon the payment of said sums, the transfer of said stock, and the hypothecation thereof, as herein provided, to forthwith deliver his resignation to Mission Bell as Director, Vice-President and Treasurer, and as to any other office or position which the records of said corporation may show he has been appointed or elected to. [300]

Schmieter agrees to relinquish any and all claims of every kind or character, which he may have against said corporation, except such right as may be created by the hypothecation of the stock above mentioned, and further agrees to fully release and discharge said corporation from any and all indebtedness to him.

It is specifically understood and agreed that Hoffman may at any time prior to the due date of the payments to be made as hereinabove provided, pay the full amount of the purchase price of said stock to the said Schmieter, and thereupon the said Schmieter shall re-transfer said stock to the said Hoffman as hereinabove provided.

Hoffman agrees that he will render, or will cause Mission Bell to render, to Schmieter, on the 10th

Exhibit No. 4—(Continued)

day of each and every month, a full, true and correct statement of the gross sales of merchandise made by Mission Bell during the preceding month, and Schmieter shall have the right at all reasonable times, but not more than once a month, however, to examine the books of said corporation for the purpose of determining the gross sales for any month or months, at all times during the life of this agreement.

It is further understood that Hoffman is endeavoring to enter into contracts with all other stockholders of said corporation for the purchase of their stock in said corporation, and that the Directors of said corporation are by resolution to employ Hoffman as General Manager, and agree that said corporation shall pay Three per cent (3%) of the gross sales of all merchandise sold by said Mission Bell, as a partial consideration for the services of Hoffman as General Manager, and that thereafter any present Directors shall resign, and elect in their place Directors to be named by Hoffman; provided that [401] since Schmieter has never accepted the appointment as a Director or officer of said corporation, he shall not be required to perform any act as such, or to join in said resolution, but he hereby gives his personal consent thereto.

It is understood between the parties hereto that Schmieter has not been actively connected with the management or operation of said company for more than one (1) year last past, and further that

Exhibit No. 4—(Continued)

said Hoffman shall be authorized to borrow for such corporation and from time to time such sums as he may deem advisable on such terms as he may see fit.

Schmieter has examined the balance sheet of said company as of October 31, 1941, as prepared by employees of Mission Bell, has initialled a copy thereof for identification, and delivered such copy to Hoffman.

Schmieter represents to Hoffman that he has not personally, for or on behalf of the corporation, incurred any liabilities which are not disclosed by said balance sheet, that he believes said balance sheet to truly and correctly reflect all the direct and contingent liabilities of the corporation, and that he has no personal knowledge of any liabilities of any kind which are not reflected by said balance sheet.

In the event any attachment or execution is levied upon any assets of the company, and the said Mission Bell or the said Hoffman fails to secure or cause to be secured a release thereof within ten (10) days after such levy, then Schmieter shall have the right, either alone or in conjunction with other stockholders, to effect a release of the lien of such attachment or execution, and in the event of such failure on the part of Mission Bell or Hoffman, then at Schmieter's option such failure to cause such release shall be deemed to be a default of the terms and conditions hereof, and the full amount of the purchase price shall forthwith be-

Exhibit No. 4—(Continued)

come due and [402] payable, subject, however, to the terms and conditions hereof, relative to the release of any personal liability of Hoffman for any deficiency, and the said Schmieter shall be entitled thereupon to sell or otherwise dispose of the stock so hypothecated, for the purpose of satisfying the obligations due him thereunder, as hereinabove **provided.**

Except as otherwise herein provided, this agreement shall be binding upon the inure to the benefit of the heirs, successors and assigns of the parties hereto.

If on or before ten days after date of this agreement Hoffman shall have failed to enter into contracts for purchase of all outstanding stock in said corporation, Hoffman may forthwith and within said 10 days terminate this contract by a notice in writing addressed to Schmieter at care of Chas. E. R. Fulcher, 411 West 5th St., Los Angeles, California, and deposited in the U. S. Mail at Los Angeles, California, postages prepaid and thereupon each of the parties hereto shall be released from all further obligations hereunder except Schmieter shall retain the \$100.00 paid upon the execution hereof as liquidated damages and the 110 shares of stock now owned by Schmieter shall be retained by him as his property free from any claim by Hoffman and Hoffman agrees to perform all acts necessary to vest such stock in his name upon the books of the corporation.

Exhibit No. 4—(Continued)

In Witness Whereof, the parties hereto have executed this agreement the day and year first hereinabove written.

/s/ H. L. HOFFMAN,
First Party.

/s/ H. G. SCHMIETER,
Second Party. [403]

EXHIBIT No. 5

This Agreement, executed in triplicate at Los Angeles, California, December 4th, 1941, by and between H. L. Hoffman, first party, sometimes hereinafter designated as "Hoffman," and Franklyn Warner and Helen E. Warner, second party, sometimes hereinafter designated as "Warner,"

Witnesseth:

The parties herein contracting do so with reference to the following facts:

Mission Bell Radio Mfg. Co., Inc., is a California corporation, having an authorized capital of One Thousand (1,000) shares of common stock of the par value of One Hundred Dollars (\$100.00) per share. There are issued and outstanding Four Hundred and Thirteen (413) shares of said stock, of which Warner is the owner and in possession of One Hundred and Ninety-three (193) shares. The board of directors and officers of said corporation, hereinafter sometimes designated as the "company," consist of the following:

Exhibit No. 5—(Continued)

P. L. Fleming, director, president and chairman of the board;

H. G. Schmieter, director, vice-president and treasurer;

M. Penny, director and secretary.

Of said issued shares of stock One Hundred and Ninety-three (193) are owned and/or controlled by Warner; One Hundred and Ten (110) by P. L. Fleming; and One Hundred and Ten (110) by H. G. Schmieter. Said company is in financial difficulties and will be unable to continue in business unless additional funds are secured by borrowing or otherwise. [404]

Now, Therefore, in consideration of the foregoing facts and the promises hereinafter set out on the part of the respective parties hereto, It Is Agreed:

1. Concurrently herewith Warner has sold to Hoffman, and Hoffman has purchased from Warner, One Hundred and Ninety-three (193) shares of said company and in payment thereof Hoffman has delivered to Warner his promissory note in the principal sum of Four Thousand Eight Hundred and Twenty-five Dollars (\$4,825.00), said promissory note being in the form of "Exhibit A" attached hereto and by reference incorporated herein.

2. Expressly for the benefit of said company, as well as for the benefit of Hoffman, Warner hereby relinquishes any and all claims of every kind and character that he may have against said company

Exhibit No. 5—(Continued)

and fully releases and discharges said company from any indebtedness to him.

3. It is understood that Hoffman has purchased or is endeavoring to purchase all of the issued and outstanding stock of said company and that in connection with such purchases Hoffman has obtained or proposes to obtain the agreement of the other stockholders and officers of the company to the effect, among other things, as follows:

(a) That each of them will do or cause to be done each and everything that may be necessary to the end that on or before December 4th, 1941, by a contract duly authorized by the Board of Directors of said company, Hoffman shall be employed as general manager thereof for a term and period of 36 months at a salary to be determined as follows: On or before the 15th day of each calendar [405] month Hoffman shall be paid as partial payment of his salary for the preceding calendar month an amount equal to Three Per Cent (3%) of the gross sales of said corporation for and during such preceding calendar month, and in addition such an amount as may from time to time be agreed upon by Hoffman and the company. Said management agreement shall also provide that said Hoffman may arrange to borrow and may borrow for and on behalf of the company at any time and from time to time such amounts as he may deem desirable and upon such terms as he may see fit. Said management agreement shall be otherwise in form and substance satisfactory to Hoffman and shall specifically provide that the same may be ter-

Exhibit No. 5—(Continued)

minated by Hoffman at any time after February 28, 1942.

(b) That immediately after said management agreement has been executed each of the present officers and directors of said company will resign in such manner that they may be forthwith replaced both as officers and directors by such persons as may be designated by Hoffman.

Warner hereby agrees that on or before December 4th, 1941, Hoffman shall be employed as General Manager of the company in the manner and upon the terms hereinbefore set out, and that the officers and directors of the company shall be replaced as hereinbefore specified and that he will do or cause to be done each and every thing that can be done by him to accomplish the agreed results; provided, however, that Warner shall not be deemed in default hereunder if Hoffman be not so employed or if said officers and directors be not so replaced, unless such results are not obtained because of some failure [406] on the part of Warner to do something which he has the right and power to do.

Notwithstanding anything to the contrary appearing herein, Warner expressly agrees that if Hoffman should be unable within days to purchase all of the stock of said company upon terms satisfactory to him, or if, having purchased the same, he should not be employed as General Manager of the company as above set forth, or if the Board of Directors and officers should not be replaced as hereinbefore specified, then at his op-

Exhibit No. 5—(Continued)

tion Hoffman may terminate this agreement and retransfer and deliver to Warner said One Hundred and Ninety-three (193) shares of stock purchased from Warner and thereupon said promissory note given by Hoffman to Warner shall be canceled and surrendered to Hoffman and each party hereto shall be relieved and released from all further obligation hereunder or under the provisions of said promissory note.

Warner hereby represents and warrants that he has in no way at any time incurred any obligations for and on behalf of Mission Bell Manufacturing Co., Inc., or by any act of his obligated said company in any manner not disclosed by and shown in the books and records of said company.

5. Hoffman expressly agrees that in the event any attachment or execution is levied upon any of the physical assets of the company and for a period of ten (10) days Hoffman fails to secure or cause to be secured a release thereof, then Warner shall have the right, either alone or in conjunction with other stockholders, to effect a release of the lien of [407] such attachment or execution, and thereupon, at Warner's option, this contract may be terminated and in the event of such termination said One Hundred and Ninety-three (193) shares of stock purchased from Warner shall be retransferred and delivered to Warner and said promissory note executed by Hoffman in favor of Warner shall be canceled, but all payments made by Hoffman to Warner on said promissory note shall be retained by Warner as liquidated damages.

Exhibit No. 5—(Continued)

6. Gross sales of merchandise shall be deemed to be all sales of merchandise made by the company after deducting therefrom all merchandise returns and all allowances made for defective merchandise or on account of discounted bills. Warner shall have the right at all reasonable times to examine the books and records of said corporation for the purpose of determining the amount of said gross sales. Hoffman agrees that as long as said promissory note, of which "Exhibit A" is a copy, shall remain in effect, and any portion thereof shall be unpaid, he will cause said company to deliver to the holder of said note at such place in the city of Los Angeles, California, as the holder shall have designated by a notice in writing to said company, a full, true and correct statement of the gross sales of merchandise made by said company during each month and that such statement for each calendar month will be so delivered on or before the 15th day of the succeeding calendar month.

7. This agreement shall be binding upon and shall inure to the benefit of the parties hereto and as well their respective heirs, personal representatives and [408] assigns.

Executed the day and year first above written.

/s/ H. L. HOFFMAN,

Party of the First Part.

/s/ FRANKLYN WARNER,

/s/ HELEN E. WARNER,

Parties of the Second Part.

Exhibit No. 5—(Continued)

EXHIBIT A

Promissory Note

\$4,825.00.

Los Angeles, California,
....., 1941.

In installments and at the times and upon the terms and conditions hereinafter stated, for value received, I promise to pay to Franklyn Warner at, Los Angeles, California, Four Thousand Eight Hundred and Twenty-five Dollars (\$4,825.00). Said principal shall be payable in installments as follows:

On the 15th day of January, 1942, and thereafter on the 15th day of each and every calendar month until the full amount of said principal sum shall have been paid, an amount equal to One Per Cent (1%) of the gross sales of all merchandise sold by Mission Bell Radio Mfg. Co., Inc., a California corporation, during the preceding calendar month, the amount of such gross sales to be determined as provided for in the contract to which reference is hereinafter made; provided always that in no event shall the payment to be made on the 15th day of any calendar month be less than the sum of One Hundred Dollars (\$100.00), and provided further that if on January 15, 1945, any portion of said principal sum remains unpaid, then the whole of the amount so remaining unpaid on said principal sum shall be paid on said 15th day of January, ~~1945~~ 1944 [H.L.H.]

Exhibit No. 5—(Continued)

Should default be made in the payment of any installment of principal when due, then, subject always to the provisions hereof releasing the undersigned from personal liability, the whole sum of principal shall become immediately due and [410] payable at the option of the holder of this note.

The undersigned hereby assigns, pledges and transfers to said Franklyn Warner One Hundred and Ninety-three (193) shares of the common capital stock of Mission Bell Radio Mfg. Co., Inc., represented by Certificates Nos. 23 to 27, inclusive, as security for the full payment of the foregoing note and all indebtedness evidenced thereby and for the performance of each of the agreements of the undersigned herein contained. The undersigned expressly retains all voting rights to **the stock** so assigned, pledged and transferred, and to all dividends paid thereon.

Upon default in the payment of said promissory note or of any installment of principal thereof, the sole right of the holder of this note shall be to receive full title to said One Hundred and Ninety-three (193) shares of stock and to retain any moneys which have heretofore been paid upon this note, and in such event the undersigned authorizes the Mission Bell Radio Mfg. Co., Inc., to transfer said stock on its books to the holder of this note. This note is executed pursuant to and as an integral part of a certain contract dated December 4th, 1941, by and between the undersigned and Franklyn Warner, and is subject to each and all of the

Exhibit No. 5—(Continued)

provisions of said contract, a signed copy of which has been delivered to Mission Bell Radio Mfg. Co., Inc., and may be seen by any person or persons who contemplate acquiring this note or any interest therein.

This note is executed subject to the express condition that it is not negotiable and that the undersigned shall have no personal liability for the indebtedness, or any portion [411] of the indebtedness, evidenced hereby, it being expressly agreed, however, that the holder hereof may assign his interest in this note by way of security or otherwise.

Upon the payment of the indebtedness hereby secured, and as well all other charges accrued hereunder, said One Hundred and Ninety-three (193) shares of stock pledged hereunder shall be forthwith redelivered to the undersigned.

This note is executed subject to the further express condition that the whole or any part of the principal may be paid at any time, and if the whole of the principal is paid within ninety (90) days from the date hereof, then the principal amount of this note shall be reduced to the sum of Four Thousand Two Hundred and Forty-six Dollars (\$4,246.00).

H. L. HOFFMAN. [412]

EXHIBIT No. 6

This Agreement, executed in triplicate at Los Angeles, California, December 4th, 1941, by and between H. L. Hoffman, first party, sometimes hereinafter designated as "Hoffman," and P. L. Fleming, second party, sometimes hereinafter designated as "Fleming,"

Witnesseth:

The parties herein contracting do so with reference to the following facts:

Mission Bell Radio Mfg. Co., Inc., is a California corporation, having an authorized capital of Five Hundred (500) shares of common stock of the par value of One Hundred Dollars (\$100.00) per share. There are issued and outstanding Four Hundred and Thirteen (413) shares of said stock, of which Fleming is the owner and in possession of One Hundred and Ten (110) shares. The board of directors and officers of said corporation, hereinafter sometimes designated as the "company," consist of the following:

P. L. Fleming, director, president and chairman of the board;

H. G. Schmieter, director, vice-president and treasurer;

M. Penny, director and secretary.

Of said issued shares of stock One Hundred and Ninety-three (193) are owned and/or controlled by Franklyn Warner, One Hundred and Ten (110) by P. L. Fleming, and One Hundred and Ten by H. G. Schmieter. Said company is in financial difficul-

Exhibit No. 6—(Continued)

ties and will be unable to continue in business unless [413] additional funds are secured by borrowing or otherwise.

Now, Therefore, in consideration of the foregoing facts and the promises hereinafter set out on the part of the respective parties hereto, It Is Agreed:

1. Concurrently herewith Fleming has sold to Hoffman and Hoffman has purchased from Fleming One Hundred and Ten (110) shares of said company and in payment thereof Hoffman has delivered to Fleming his promissory note in the principal sum of Two Thousand Seven Hundred Fifty Dollars (\$2,750.00), said promissory note being in the form of "Exhibit A" attached hereto and by reference incorporated herein.

2. It is understood that said company is indebted to Fleming on a certain promissory note executed by it in favor of Fleming in the principal sum of One Thousand Dollars (\$1,000.00) and certain accrued and unpaid interest, and also in the sum of Fifteen Hundred Dollars (\$1500.00) for salary on account of services rendered by Fleming as an officer of said company. Expressly for the benefit of said company, as well as for the benefit of Hoffman, Fleming agrees that he will take no action to enforce the payment of said note or any part thereof prior to January 15, 1942; that if on January 15, 1942, said company shall pay to Fleming on account of the principal of said note the sum of Eighty-three Dollars and Thirty-

Exhibit No. 6—(Continued)

seven Cents (\$83.37) and thereafter, on or before the 15th day of each succeeding calendar month until the full principal sum of One Thousand Dollars (\$1,000.00) shall have been paid, shall pay to Fleming the sum of Eighty-three Dollars and Thirty-three Cents (\$83.33), Fleming will take no action to enforce the payment of said note or any portion thereof, and when and if [414] the full sum of One Thousand Dollars (\$1,000.00) shall have been so paid, will fully cancel said note, including principal and all interest accrued and unpaid thereon. Fleming further agrees, expressly for the benefit of said company as well as for the benefit of Hoffman, that he will not take any action to enforce his claim against said company for salary earned and unpaid prior to January 15, 1943, and that on January 15, 1943, he will agree to a further extension of the time of payment of such claim unless on or prior to January 15, 1943, said company is in a position to pay dividends on its stock aggregating the sum of Fifteen Hundred Dollars (\$1500.00), it being expressly agreed that, for the purpose of determining whether or not said company is in a position to pay such dividends, salaries paid to officers and/or employees of said company who during said year have been stockholders of said company shall be taken to aggregate not more than Twelve Thousand Dollars (\$12,000.00).

Notwithstanding anything to the contrary appearing in this numbered paragraph, it is expressly agreed that any agreement herein contained on the

Exhibit No. 6—(Continued)

part of Fleming to defer action to collect any money due to him from said company shall be no longer binding if at any time said company shall be adjudicated bankrupt, or if at any time a writ of attachment or writ of execution shall be levied upon any of the physical assets of the company and shall not be released within ten (10) days after the same shall have been levied.

Except as to the promissory note aforesaid in the principal sum of One Thousand Dollars (\$1,000.00), and the [415] Fifteen Hundred Dollars (\$1500.00) owing as aforesaid on account of salary, Fleming, expressly for the benefit of said company, as well as for the benefit of Hoffman, hereby relinquishes any and all claims of every kind and character that he may have against said company and fully releases and discharges said company from any indebtedness to him.

3. It is understood that Hoffman has purchased or is endeavoring to purchase all of the issued and outstanding stock of said company and that in connection with such purchases Hoffman has obtained, or proposes to obtain, the agreement of the other stockholders and officers of the company to the effect, among other things, as follows:

(a) That each of them will do or cause to be done each and every thing that may be necessary to the end that on or before December 4th, 1941, by a contract duly authorized by the board of directors of said company, Hoffman shall be employed or general manager thereof for a term and [416]

Exhibit No. 6—(Continued)

period of 36 months at a salary to be determined as follows: On or before the 15th day of each calendar month Hoffman shall be paid as partial payment of his salary for the preceding calendar month an amount equal to Three Per Cent (3%) of the gross sales of said corporation for and during such preceding calendar month and in addition such an amount as may from time to time be agreed upon by Hoffman and the company. Said management agreement shall also provide that said Hoffman may arrange to borrow and may borrow for and on behalf of the company at any time and from time to time such amounts as he may deem desirable and upon such terms as he may see fit. Said management agreement shall be otherwise in form and substance satisfactory to said Hoffman and shall specifically provide that the same may be terminated by Hoffman at any time after February 28, 1942.

(b) That immediately after said management agreement has been executed each of the present officers and directors of said company will resign in such manner that they may be forthwith replaced both as officers and directors by such persons as may be designated by Hoffman.

Fleming hereby agrees that on or before December 4th, 1941, Hoffman shall be employed as General Manager of the company in the manner and upon the terms hereinbefore set out, and that the officers and directors of the company shall be replaced as hereinbefore specified and that he will

Exhibit No. 6—(Continued)

do or cause to be done each and every thing that can be done by him to accomplish the agreed results; provided, however, that Fleming shall not be deemed in default hereunder if [417] Hoffman be not so employed or if said officers and directors be not so replaced, unless such results are not obtained because of some failure on the part of Fleming to do something which he has the right and power to do.

Notwithstanding anything to the contrary appearing herein, Fleming expressly agrees that if Hoffman should be unable with days to purchase all of the stock of said company upon terms satisfactory to him, or if, having purchased the same, he should not be employed as General Manager of the company as above set forth, or if the Board of Directors and officers should not be replaced as hereinbefore specified, then at his option Hoffman may terminate this agreement and retransfer and deliver to Fleming said One Hundred and Ten (110) shares of stock purchased from Fleming, and thereupon said promissory note given by Hoffman to Fleming shall be canceled and surrendered to Hoffman and each party hereto shall be relieved and released from all further obligation hereunder or under the provisions of said promissory note.

4. Fleming hereby expressly represents and warrants to Hoffman that all of the liabilities of the Mission Bell Radio Mfg. Co., Inc., both fixed and contingent, are disclosed by and shown upon

Exhibit No. 6—(Continued)

that balance sheet of said company of which a copy, initialed by the parties hereto for identification, has been delivered to Hoffman.

5. Hoffman expressly agrees that in the event any attachment or execution is levied upon any of the physical assets of the company and for a period of ten (10) days Hoffman [418] fails to secure or cause to be secured a release thereof, then Fleming shall have the right, either alone or in conjunction with other stockholders, to effect a release of the lien of such attachment or execution, and thereupon, at Fleming's option, this contract may be terminated and in the event of such termination said One Hundred and Ten (110) shares of stock purchased from Fleming shall be retransferred and delivered to Fleming, and said promissory note executed by Hoffman in favor of Fleming shall be canceled, but all payments made by Hoffman to Fleming on said promissory note shall be retained by Fleming as liquidated damages.

6. Gross sales of merchandise shall be deemed to be all sales of merchandise made by the company after deducting therefrom all merchandise returns and all allowances made for defective merchandise or on account of discounted bills. Fleming shall have the right at all reasonable times to examine the books and records of said corporation for the purpose of determining the amount of said gross sales. Hoffman agrees that as long as said promissory note, of which "Exhibit A" is a copy, shall remain in effect and any portion thereof shall be

Exhibit No. 6—(Continued)

unpaid, he will cause said company to deliver to the holder of said note at such place in the city of Los Angeles, California, as the holder shall have designated by a notice in writing to said company, a full, true and correct statement of the gross sales of merchandise made by said company during each month and that such statement for each calendar month will be so delivered on or before the 15th day of the succeeding calendar month. [419]

7. This agreement shall be binding upon and shall inure to the benefit of the parties hereto and as well their respective heirs, personal representatives and assigns.

Executed the day and year first above written.

/s/ H. L. HOFFMAN,

Party of the First Part.

/s/ P. L. FLEMING,

Party of the Second Part.

EXHIBIT A

Promissory Note

\$2,750.00.

Los Angeles, California.

....., 1941.

In installments and at the times and upon the terms and conditions hereinafter stated, for value received, I promise to pay to P. F. Fleming at 10601 Ashton Ave., West Los Angeles, California, Two Thousand Seven Hundred and Fifty Dollars

Exhibit No. 6—(Continued)

(\$2,750.00). Said principal shall be payable in installments as follows:

On the 15th day of January, 1942, and thereafter on the 15th day of each and every calendar month until the full amount of said principal sum shall have been paid, an amount equal to One Per Cent (1%) of the gross sales of all merchandise sold by Mission Bell Radio Mfg. Co., Inc., a California corporation, during the preceding calendar month, the amount of such gross sales to be determined as provided for in the contract to which reference is hereinafter made; provided always that in no event shall the payment to be made on the 15th day of any calendar month be less than the sum of One Hundred Dollars (\$100.00), and provided further that if on January 15, 1944, any portion of said principal sum remains unpaid, then the whole of the amount so remaining unpaid on said principal sum shall be paid on said 15th day of January, 1944.

Should default be made in the payment of any installment of principal due, then, subject always to the provisions hereof releasing the undersigned from personal liability [421] the whole sum of principal shall become immediately due and payable at the option of the holder of this note.

The undersigned hereby assigns, pledges and transfers to said P. L. Fleming One Hundred and Ten (110) shares of the common capital stock of Mission Bell Radio Mfg. Co., Inc., represented by Certificates Nos. as security for the

Exhibit No. 6—(Continued)

full payment of the foregoing note and all indebtedness evidenced thereby and for the performance of each of the agreements of the undersigned herein contained. The undersigned expressly retains all voting rights to the stock so assigned, pledged and transferred, and to all dividends paid thereon.

Upon default in the payment of said promissory note or of any installment of principal thereof, the sole right of the holder of this note shall be to receive full title to said One Hundred and Ten (110) shares of stock and to retain any moneys which have heretofore been paid upon this note, and in such event the undersigned authorizes the Mission Bell Radio Mfg. Co., Inc., to transfer said stock on its books to the holder of this note. This note is executed pursuant to and as an integral part of a certain contract dated, 1941, by and between the undersigned and P. L. Fleming and is subject to each and all of the provisions of said contract, a signed copy of which has been delivered to Mission Bell Radio Mfg. Co., Inc., and may be seen by any person or persons who contemplate acquiring this note or any interest therein.

This note is executed subject to the express condition that it is not negotiable and that the undersigned shall have no personal liability for the indebtedness, or any portion of the indebtedness, evidenced hereby, it being expressly agreed, however, that the holder hereof may assign his interest [422] in this note by way of security or otherwise.

Exhibit No. 6—(Continued)

Upon the payment of the indebtedness hereby secured, and as well all other charges accrued hereunder, said One Hundred and Ten (110) shares of stock pledged hereunder shall be forthwith re-delivered to the undersigned.

This not is executed subject to the further express condition that the whole or any part of the principal may be paid at any time and that, if the whole of the principal be paid within ninety (90) days from the date hereof, then the principal amount of this note shall be reduced to the sum of Two Thousand Four Hundred and Twenty Dollars (\$2,420.00).

/s/ H. L. HOFFMAN. [423]

EXHIBIT No. 7

This Agreement, executed in quadruplicate at Los Angeles, California, December 9th, 1941, by and between H. L. Hoffman, first party, sometimes hereinafter designated as "Hoffman," G. Gifford Davidge, second party, sometimes hereinafter designated as "Davidge," and Walter D. Douglas, third party, sometimes hereinafter designated as "Douglas,"

Witnesseth:

The parties herein contracting do so with reference to the following facts:

Mission Bell Radio Mfg. Co., Inc., hereinafter sometimes designated as "Mission Bell," is a California corporation, having an authorized capital

Exhibit No. 7—(Continued)

of Five Hundred (500) shares of common stock of the par value of One Hundred Dollars (\$100.00) per share. There are issued and outstanding Four Hundred Thirteen (413) shares of said stock.

Under date of December 1, 1941, Hoffman entered into a contract in writing with one H. G. Schmieter relative to the purchase from Schmieter of One Hundred Ten (110) shares of said stock for the sum of Four Thousand One Hundred Eighty Dollars (\$4,180.00). Said contract provides, among other things, for the payment of One Hundred Dollars (\$100.00) on account of the purchase price upon the execution of the contract, and for payments on account of the balance of the purchase price in equal installments on the 10th day of each calendar month beginning January 10, 1942 (each such installment to be an amount equal to One Per Cent [424] (1%) of the gross sales of all merchandise of said Mission Bell during the preceding calendar month) and, further, that the unpaid balances of the purchase price shall bear interest at annum [G.D.] the rate of Three Per Cent (3%) per ~~month~~, payable monthly, and that the payments on account of the principal shall be not less than One Hundred Dollars (\$100.00) each month, and for the payment in full thirty-six (36) months from the date of the first payment of any balance then unpaid on the principal amount. Said contract further provides in effect that Hoffman is to be employed as General Manager of Mission Bell and as part compensation for his services shall receive a monthly

Exhibit No. 7—(Continued)

sum equal to Three Per Cent (3%) of the gross sales of all merchandise of Mission Bell during the preceding calendar month. Said contract also provides in effect that after Hoffman shall have been so employed as manager the officers and directors of Mission Bell shall be replaced by officers and directors designated by Hoffman. Each of the parties hereto is familiar with said contract and the same is by reference incorporated herein. Hoffman has heretofore paid the One Hundred Dollars (\$100.00) to be paid as in said contract provided upon the execution thereof and the One Hundred Ten (110) shares of stock with which said contract deals have been issued to Hoffman and have been by him pledged with Schmieter as security for the performance of Hoffman's obligations in and under said contract.

Under date of December 4, 1941, Hoffman entered into a contract in writing with Franklyn Warner and Helen E. Warner, hereinafter referred to as "the Warners," whereby Hoffman purchased from the Warners One Hundred Ninety-three [426] (193) shares of the stock of Mission Bell and gave therefor his promissory note in the principal sum of Four Thousand Eight Hundred Twenty-five Dollars (\$4,825.00). Said promissory note provides that the principal thereof shall be payable in equal installments each calendar month, commencing on 15th day of January, 1942, each of such installments to be an amount equal to One Per Cent (1%) of the gross sales of all merchandise sold by Mission Bell

Exhibit No. 7—(Continued)

during the preceding calendar month provided that no installment payment shall be less than the sum of One Hundred Dollars (\$100.00), and for the payment in full on January 15, 1944, of any balance then unpaid on the principal amount. Said contract with said Warners, hereinafter sometimes referred to as "the Warner contract," provides for the employment of Hoffman as General Manager of Mission Bell and for the appointment of directors and officers of Mission Bell, substantially as provided for in the Schmieter contract aforesaid. Each of the parties hereto is familiar with said Warner contract and said promissory note and the same are by reference incorporated herein.

Under date of December 4, 1941, Hoffman entered into a contract in writing with P. L. Fleming, hereinafter sometimes referred to as "the Fleming contract," whereby Hoffman purchased from Fleming One Hundred Ten (110) shares of the stock of said Mission Bell, for which Hoffman executed his promissory note in the principal sum of Two Thousand Seven Hundred Fifty Dollars (\$2,750.00). Said promissory note provides that the principal thereof shall be payable in ~~equal~~ [H.L.H., G.D.] installments each calendar month, commencing on the 15th day of January, 1942, each of such installments to be an amount equal to One Per cent (1%) of the gross sales of all merchandise sold by Mission Bell during the preceding calendar month, provided that no installment payment shall be less than the sum of One Hundred Dollars (\$100.00), and for the

Exhibit No. 7—(Continued)

payment in full on January 15, 1944, of any balance then unpaid on the principal amount. Said contract with said Fleming provides for the employment of Hoffman as General Manager of Mission Bell and for the appointment of directors and officers of Mission Bell substantially as provided for in the Schmieter and Warner contracts aforesaid. Each of the parties hereto is familiar with said Fleming contract and said promissory note and the same are by reference incorporated herein.

Said Mission Bell is in financial difficulties and the same cannot be continued in operation unless money can be borrowed for the use of said corporation, and there is a question as to whether said Mission Bell can be operated successfully even if money can be secured by borrowing. Hoffman is willing to lend Two Thousand Dollars (\$2,000.00) to said Mission Bell under the circumstances and upon the conditions hereinafter set forth and each of the other parties hereto, upon the conditions hereinafter set forth and not otherwise, is willing to lend the sum of Four Thousand Dollars (\$4,000.00) to said Mission Bell.

Now, Therefore, in consideration of the foregoing facts and the promises hereinafter set forth on the part of the respective parties hereto, It Is Agreed:

1. There shall be lent to Mission Bell forthwith [427] the sum of Ten Thousand Dollars (\$10,000.00). Of said sum Hoffman agrees to contribute the sum of Two Thousand Dollars (\$2,000.00);

Exhibit No. 7—(Continued)

Davidge agrees to contribute the sum of Four Thousand Dollars (\$4,000.00), and Douglas agrees to contribute the sum of Four Thousand Dollars (\$4,000.00). The loan so made to Mission Bell shall be evidenced by a promissory note payable on demand, executed by the corporation in favor of Hoffman as trustee for himself, Davidge and Douglas, and the respective interests of the persons named in said promissory note and the security therefor shall be in proportion to their contributions and without priority of one interest over the other. The determination of what is to be done or not done with reference to said promissory note and/or the indebtedness evidence thereby may be made by the contributors of a majority in amount of the money lent to said Mission Bell and Hoffman agrees to act in accordance with any such determination.

2. It is understood and agreed that the parties hereto shall constitute the Board of Directors of Mission Bell; that Hoffman shall be the President and General Manager thereof; that Davidge shall be the Vice-President thereof and that Douglas shall be the Secretary and Treasurer thereof. Each of the parties hereto agrees to do such things as are proper and lawful to the end that the agreements set out in this numbered paragraph may be made effective.

the rights which he has in and to the stock of said Mission Bell and in and under said contracts with

Exhibit No. 7—(Continued)

Schmieter, with the Warners and with Fleming are held by him in trust for the benefit of himself, Davidge and Douglas for the purpose of [428] making effective each and all of the agreements contained in this contract.

4. When and if Hoffman shall have obtained full and complete ownership of the stock covered by said contracts with Schmieter, the Warners and Fleming, free and clear of any claims arising out of said contracts and/or the promissory notes referred to in the contracts with the Warners and Fleming, Fifty Per Cent (50%) of said stock shall be issued to and in the name of Hoffman and shall be held by him in his own right and not as trustee. Twenty-five Per Cent (25%) thereof shall be issued to and shall be held by Davidge as his own separate property, and Twenty-five Per Cent (25%) thereof shall be issued to and shall be held by Douglas as his own separate property, and thereupon the trust relating to the rights in said contracts and said stock shall terminate.

5. If at any time any two of the parties to this contract shall determine that the operations of Mission Bell cannot be continued successfully, then Hoffman shall make no further payments to Schmieter as provided in said contract with Schmieter, and Hoffman shall make no further payments upon the aforesaid promissory note to Franklyn Warner or on the said promissory note to Fleming, and Hoffman shall do those things which are to be done by him in such event as provided in the respective contracts with Schmieter, the War-

Exhibit No. 7—(Continued)

ners and Fleming, and thereupon the trust relative to the rights in said stock and the rights under said contracts shall terminate.

6. Hoffman agrees that while he is General Manager [429] of Mission Bell and is receiving as whole or part compensation for his services an amount based upon the gross sales of Mission Bell and equal to Three Per Cent (3%) of such gross sales he will use that portion of his salary which is equal to Three Per Cent (3%) of such gross sales to make the payments provided for in said contracts with Schmieter, the Warners and Fleming and the promissory notes executed by him as aforesaid in favor of Franklyn Warner and Fleming. If in any month the amount equal to One Per Cent (1%) of the gross business done by Mission Bell during the preceding month which is to be paid under the provisions of each of said contracts relating to the purchase by Hoffman of stock in said Mission Bell is less than the One Hundred Dollar (\$100.00) minimum payment to be made as in each of said contracts provided, then the amount of the difference shall be contributed by the parties hereto in the following proportions: One-half ($\frac{1}{2}$) thereof by Hoffman; One-fourth ($\frac{1}{4}$) thereof by Davidge; and One-fourth ($\frac{1}{4}$) thereof by Douglas. The amounts required to pay interest to Schmieter as provided in the contract with him shall be contributed in like manner by the parties hereto. None of said contributions shall be made when and if it shall have been determined that no further payments are to be made under said contracts or upon the promissory notes in favor of Franklyn Warner and Fleming.

Exhibit No. 7—(Continued)

7. An executed copy of this agreement shall be filed with Mission Bell to evidence the interest of the respective parties hereto in and to the stock of said corporation.

8. None of the parties hereto shall transfer, assign, hypothecate or otherwise dispose of any interest in and under this contract and/or in and to any interest in any trust declared and/or created hereby; provided, however, that nothing herein contained shall prevent the interest of any such party from passing by testamentary disposition or by the laws of succession, but nothing herein contained shall give to any person other than Hoffman any right to be the General Manager of Mission Bell except with the consent of the other parties hereto. As between the parties hereto it is agreed that in the event of Hoffman's death one of the other parties hereto may be made General Manager of Mission Bell and may receive compensation for his services as such similar to that received by Hoffman, and in such event a portion of his compensation equal to Three Per Cent (3%) of the gross sales of Mission Bell shall be used to make the monthly payments to be made under the provisions of said contracts with Schmieter, the Warners and Fleming.

Executed the day and year first above written.

/s/ H. L. HOFFMAN,

/s/ G. GIFFORD DAVIDGE,

/s/ WALTER D. DOUGLAS. [431]

EXHIBIT No. 8

STOCK OWNERSHIP

HOFFMAN RADIO CORPORATION

	H. L. Hoffman	W. D. Douglas	G. C. Davidge
--	---------------	---------------	---------------

Common Stock

413 shares outstanding in the month of December, 1941, and the years 1942 and 1943.

Ownership of record.....	411	1	1
--------------------------	-----	---	---

	H. L. Hoffman	W. D. Douglas	G. C. Davidge
--	---------------	---------------	---------------

On January 2, 1944, certificates endorsed to show ownership and Wife as follows

	206 $\frac{1}{2}$	103 $\frac{1}{4}$	103 $\frac{1}{4}$
--	-------------------	-------------------	-------------------

Preferred Stock

725 shares of stock authorized and paid for in 1943, and certificates issued January 2, 1944, as follows.....

	125	415	185
--	-----	-----	-----

EXHIBIT No. 9
 HOFFMAN RADIO CORPORATION—COMPARATIVE BALANCE SHEET
 1941-1943 INCLUSIVE

ASSETS		Jan. 1, 1941	Dec. 31, 1941	Dec. 31, 1942	Dec. 31, 1943
Current Assets					
Cash		\$ 785.14	\$ 3,140.41	\$ 11,830.51	\$ 62,628.22
U. S. Treasury Notes.....		.....	.....	.....	50,000.00
Notes and Accounts Receivable.....		5,682.97	667.72	61,820.94	354,264.36
Inventories		13,930.60	9,128.53	52,618.16	242,061.96
Development Advance Receivable.....		.....	.....	.....	84,502.61
		<u>\$ 20,398.71</u>	<u>\$ 12,936.66</u>	<u>\$126,269.61</u>	<u>\$793,457.15</u>
Fixed Assets					
Land, Buildings, and Machinery.....		\$ 2,718.65	\$ 2,456.65	\$ 21,062.89	\$ 84,434.59
Reserve for Depreciation.....		2,018.46	2,275.71	3,924.54	20,441.69
		<u>\$ 700.19</u>	<u>\$ 180.94</u>	<u>\$ 17,138.35</u>	<u>\$ 63,992.90</u>
Other Assets		<u>\$ 20,274.74</u>	<u>\$ 5,988.77</u>	<u>\$ 4,213.99</u>	<u>\$ 20,098.64</u>
Total Assets		<u>\$ 41,373.64</u>	<u>\$ 18,206.37</u>	<u>\$147,621.95</u>	<u>\$877,548.69</u>

Exhibit No. 9—(Continued)

LIABILITIES AND CAPITAL

	Jan. 1, 1941	Dec. 31, 1941	Dec. 31, 1942	Dec. 31, 1943
Current Liabilities				
Accounts Payable	\$ 7,685.91	\$ 13,064.26	\$ 71,414.58	\$ 97,122.60
Notes Payable .....	.....	1,000.00	30,000.00	233,448.17
Accrued Expenses	1,199.27	1,254.83	9,317.80	151,935.40
Reserve for Federal Taxes .....	.....	.....	.....	* 137,146.38
Reserve for Renegotiation .....	.....	.....	.....	51,192.00
	<u>\$ 8,885.18</u>	<u>\$ 15,319.09</u>	<u>\$ 110,732.38</u>	<u>\$ 670,844.55</u>
Deferred Liabilities				
Mortgage Payable .....	.....	.....	.....	\$ 27,000.00
Reserve for Contract Guarantee.....	.....	.....	.....	22,641.30
				<u>\$ 49,641.30</u>
Capital Accounts				
Capital Stock—Preferred	\$	\$	\$	\$ 72,500.00
Capital Stock—Common	41,300.00	41,300.00	41,300.00	41,300.00
Surplus—Paid in	10,373.71	10,373.71	10,373.71	10,373.71
Surplus—Earned	19,185.25**	48,786.43**	14,784.14**	* 32,889.13
	<u>\$ 32,488.46</u>	<u>\$ 2,887.28</u>	<u>\$ 36,889.57</u>	<u>\$ 157,062.84</u>
Total Liabilities and Capital.....	<u>\$ 41,373.64</u>	<u>\$ 18,206.37</u>	<u>\$ 147,621.95</u>	<u>\$ 877,548.69</u>

* Computation does not reflect the tax deficiency on the deduction disallowance at issue herein.

EXHIBIT No. 10

HOFFMAN RADIO CORPORATION

ANALYSIS OF REVISED SURPLUS

	Dr.	Cr.	
Balance 12/31/39 per Books.....			\$ 8,293.75*
Loss for Year 1940.....	\$ 11,891.50		
Adjustment Paid in Surplus..		\$ 1,000.00	
Balance 12/31/40			19,185.25*
Loss 1941	15,470.54		
Write Off of Goodwill.....	14,130.64		
Balance 12/31/41			48,786.43*
Profit 1942		36,389.06	
1942 Income Tax	2,386.77		
Balance 12/31/42			14,785.14*
Profit 1943		171,432.94	
1943 Income Tax	137,146.38†		
Post War Refund		13,386.71†	
Balance 12/31/43			32,889.13†

† Computation does not reflect the tax deficiency on the deduction disallowance at issue herein.

* Figures in red.

EXHIBIT No. 11

 HOFFMAN RADIO CORPORATION (Formerly Mission Bell Radio Mfg. Co., Inc.)
 COMPARATIVE PROFIT AND LOSS STATEMENT—Years 1940-1943 Inclusive

	1940	1941	1942	1943
Net Sales	\$ 121,812.16	\$ 29,763.83	\$ 351,950.62	\$ 1,787,850.14
Cost of Sales	99,677.60	30,930.30	259,365.15	1,354,803.95
Gross Profit on Sales.....	\$ 22,134.56	(1,166.48)	\$ 92,585.47	\$ 433,046.19
Other Income	839.81	3,769.74	1,448.57	.....
Total Income	\$ 22,974.37	\$ 2,603.26	\$ 94,034.04	\$ 433,046.19
Expenses (other than compensation of Pres. and Vice-Pres.)..	\$ 24,665.87	\$ 15,709.80	\$ 31,712.28	\$ 175,828.97
Net Income before compensation of Officers and before Federal Taxes	(\$ 1,697.50)	(\$ 13,106.54)	\$ 62,321.76	\$ 257,217.22
Compensation of President and Vice President.....	\$ 10,200.00	\$ 2,364.00	\$ 25,932.70	\$ 85,784.28*
Net Income before Federal Taxes.....	(\$ 11,891.50)	(\$ 15,470.54)	\$ 36,389.06	\$ 171,432.94*
Federal Income and Excess Profits Taxes.....	None	None	\$ 2,386.77	\$ 123,759.67*
Net Income after Taxes.....	(\$ 11,891.50)	(\$ 15,470.54)	\$ 34,002.29	\$ 47,673.27*
Dividends Paid	None	None	None	None

EXHIBIT No. 12

Minutes of Special Meeting of Board of Directors
of Mission Bell Radio Mfg. Co. Inc.

A Special Meeting of the Board of Directors of Mission Bell Radio Mfg. Co. Inc., was held on December 4th, 1941, at the hour of 3:00 o'clock P.M. immediately following the meeting of Stockholders. Present at said meeting were the following directors: P. L. Fleming and M. E. Penney. There was also present at said meeting Mr. H. L. Hoffman, a stockholder of this corporation who holds 108 shares of the capital stock of this corporation acquired from H. G. Schmieter. The Chairman called the meeting to order and the following proceedings were had:

It was brought to the attention of the Board that Director H. G. Schmieter had transferred and assigned his stock in this corporation and had tendered his resignation dated December 1, 1941, as Vice-President and Treasurer and as a member of the Board of Directors. Upon motion duly made, seconded and unanimously carried the resignation of said H. G. Schmieter was accepted.

A vacancy in the Board existing by reason of the foregoing resignation, upon motion duly made, seconded and carried, Mr. H. L. Hoffman was nominated and duly elected as a Director of this corporation in the place and stead of said H. G. Schmieter. Mr. H. L. Hoffman being present accepted said office. [436]

The matter then came before the Board of employing H. L. Hoffman as the General Manager of

Exhibit No. 12—(Continued)

this corporation. Thereupon and upon motion duly made, seconded and unanimously carried, the following resolution was unanimously adopted:

Resolved: That P. L. Fleming, as President, and M. E. Penney, as Secretary be and they are hereby authorized and directed for and on behalf of this corporation to have prepared and to execute a contract for and on behalf of this corporation to and with said H. L. Hoffman wherein and whereby said H. L. Hoffman shall be employed by this corporation as General Manager thereof for a term and period of thirty-six (36) Months from and after the date hereof, at a salary to be computed as follows, to wit: On or before the 15th day of each calendar month said Hoffman shall be paid as partial payment for his services for each preceding calendar month a sum equal to 3% of all gross sales of this corporation for and during such each preceding calendar month, and in addition thereto said Hoffman shall be paid such other amounts as may from time to time hereafter be agreed upon between this corporation and said H. L. Hoffman. That said contract shall further provide that said Hoffman shall have the power and be authorized to borrow for and on behalf of this corporation at any time and from time to time such amounts as he may deem desirable and upon such terms as he may see fit. By said contract said H. L. Hoffman will agree to render such services as General Manager for the period of thirty-six months above specified, subject to the right of said Hoffman to ter-

Exhibit No. 12—(Continued)

minate said agreement at any time on or after February 28th, 1942, as he may elect.

Mr. Hoffman then advised the Board that he had negotiations pending to acquire the stock of this corporation owned by M. E. Penney, J. Baum and Helen Warner.

Mr. Fleming advised the Board that under and pursuant to a transaction pending between H. L. Hoffman and Helen Warner whereby Hoffman may acquire the stock of said Helen Warner, that in order to consummate the same said Helen Warner and her husband Franklyn Warner require a release to be executed [437] by this corporation releasing said Helen Warner and Franklyn Warner of any and all claims of any kind or character which this corporation may have or may assert as against them or either of them.

The Board was then advised that this corporation has no claims as against said Helen Warner and Franklyn Warner, but that nevertheless in order that said transaction of Mr. Hoffman with them might be consummated it was the concensus of opinion that this corporation should execute such release. Thereupon on motion duly made, seconded and carried, the following resolution was unanimously adopted:

Resolved: That P. L. Fleming, as President of this corporation be, and he is hereby authorized to execute a release for and on behalf of this corporation releasing and discharging said Helen Warner and/or Franklyn Warner from any and all

Exhibit No. 12—(Continued)

claims of any kind or character which this corporation may have or may assert as against said Helen Warner and/or Franklyn Warner.

Mr. Hoffman thereupon requested the Board to adjourn and recess this meeting for a period of thirty minutes. Thereupon upon motion duly made, seconded and carried the meeting was adjourned and recessed for one-half hour.

The meeting of the Board reconvened at 3:30 P.M., same day, and same persons being present. Mr. Hoffman advised the Board that during the recess period he had consummated his transaction for the acquisition of the stock of M. E. Penney, J. Baum and Helen Warner, and also consummated a transaction for the acquisition of the stock of P. L. Fleming. Thereupon M. E. Penney tendered her resignation as Secretary and as a Director of this corporation. Upon motion duly made, seconded and carried said resignation was accepted. In order to fill the vacancy created by the resignation of said M. E. Penney, Mr. Walter Douglas, II. was thereupon unanimously elected a Director of this corporation in the place and stead of said M. E. Penney.

Mr. P. L. Fleming then tendered his resignation as President and as a Director of this corporation, which resignation, on motion duly made, seconded and carried, was accepted. Thereupon on motion duly made, seconded and carried, Mr. Gifford Davidge was elected as a Director of this corporation in the place and stead of P. L. Flem-

Exhibit No. 12—(Continued)

ing. Mr. Douglas and Mr. Davidge both being present accepted said offices.

By reason of the foregoing proceedings the Board of Directors consisting of H. L. Hoffman, Walter Douglas, II. and Gifford Davidge assumed their respective positions as Directors, and proceeded to and did by motion moved, seconded and unanimously carried elect the following to be officers of this corporation, to wit: H. L. Hoffman, as President, Walter Douglas, II. as Vice-President and Treasurer, and Gifford Davidge as Secretary.

There being no further business to come before the meeting, the same was on motion duly made, seconded and carried, adjourned.

/s/ P. L. FLEMING,
/s/ M. E. PENNEY,
/s/ H. L. HOFFMAN,
/s/ WALTER DOUGLAS, II.,
/s/ GIFFORD DAVIDGE. [439]

EXHIBIT No. 13

Meeting of the Board of Directors of the Mission
Bell Radio Mfg. Co., Inc.

Held at 3765 South Broadway Place, Los Angeles, California, on the 14th day of May, 1942.

We, the undersigned, being the majority of the Board of Directors of the Mission Bell Radio

Exhibit No. 13—(Continued)

Mfg. Co., Inc., hereby give our written consent to the meeting of the Board of Directors on the above date:

Present:

/s/ H. L. HOFFMAN,

/s/ WALTER D. DOUGLAS.

The meeting was called to order and the following business came before the house:

It was brought before the Board of Directors by Mr. Hoffman that contracts on hand with Bendix Aviation, Ltd., amounted to approximately \$300,000 and that prospects for future military work seemed to be promising. It was also pointed out that our present quarters were not adequate for the volume and type of work that we are doing, and they also do not meet the requirements of the Signal Corps.

Negotiations with the Lloyd Corporation through the Ross W. Campbell Company have been under way for a new lease at 3430 South Hill. The terms of this lease were discussed. A motion was made to accept the lease on certain basis. Copies of these terms are attached to the minutes of this meeting as well as the lease. The motion was seconded and carried.

It was suggested by Mr. Hoffman that copy of our letter of March 10 relative to salary and bonus arrangement with Mr. Walter S. Harmon be recorded in the minutes of the Corporation. This was agreed upon inasmuch as all members of the Board

Exhibit No. 13—(Continued)

of Directors were familiar with this arrangement, and copy of this contract is included in the minutes of the meeting.

The subject of management personal cars was also discussed at this meeting and it was decided that a Packard 1942 Clipper of Mr. H. L. Hoffman would be registered in the Company's name and his account credited with the market value of the car. Mr. Hoffman in turn would take a lien on the car until such time as the car is either paid for or transferred back to Mr. Hoffman. Motion was duly made, seconded and carried. [440] It was also decided that the 1940 Pontiac Station Wagon of Mr. Walter Douglas would also be registered in the Company's name and his account credited with the market value of the station wagon. Mr. Douglas in turn would take a lien on the station wagon until such time as it is either paid for or transferred back to Mr. Douglas. Motion was duly made, seconded and carried.

Salaries for executives of the Company were discussed. It was pointed out by Mr. Hoffman that it would be necessary to terminate his connection with Peerless Electrical Products Company because of his duties at Mission Bell Radio Mfg. Co., and thereby eliminate this source of income. To compensate for this, motion was duly made, seconded and carried that his salary would be set at \$800.00 per month.

Motion was made by Mr. Hoffman that the salary of Mr. Walter D. Douglas be set up on the

Exhibit No. 13—(Continued)

books at \$350.00 per month. Motion was duly seconded and carried.

It was also discussed that officers and members of the Board of Directors who were called into the armed services would be given a leave of absence and paid a nominal salary of \$100.00 per month. Motion duly made, seconded and carried.

Approved:

/s/ H. L. HOFFMAN,
/s/ WALTER D. DOUGLAS,
Treasurer. [441]

Mar. 10, 1942.

Mr. Walter S. Harmon
3765 So. Broadway Pl.
Los Angeles, Calif.

Dear Mr. Harmon:

Confirming our conversation and verbal agreement in January, this letter is to confirm our arrangement at that time. Mission Bell Radio Mfg. Co., Inc., will pay you a salary of Seventy-five Dollars (\$75.00) per week.

In addition to the above, we will pay you an override of one per cent (1%) on the gross volume of business done by the Company after excise tax and other applicable taxes are deducted.

Payment of this bonus will be made annually and semi-annually if agreeable to both parties.

Exhibit No. 13—(Continued)

This arrangement will be applicable to the year 1942 and renewable upon the consent of both parties.

Sincerely yours,

MISSION BELL RADIO MFG.
CO., INC.

By H. L. HOFFMAN, Pres.

HLH:G

EXHIBIT No. 14

Agreement

This Agreement, executed in duplicate at Los Angeles, California, this 4th day of December, 1941, by and between Mission Bell Radio Mfg. Co. Inc., a corporation, hereinafter referred to as First Party, and H. L. Hoffman, of Los Angeles, California, hereinafter referred to as Second Party;

Witnesseth:

That First Party does hereby agree to and does employ Second Party to act and serve as General Manager of this corporation for a period of thirty-six (36) months from and after the date hereof. That for said services Second Party shall be paid as follows, to wit: On or before the 15th day of each calendar month said Second Party shall be paid as partial payment for his services for each preceding calendar month an amount equal to

Exhibit No. 14—(Continued)

three per cent (3%) of all gross sales of this corporation for and during such each preceding calendar month, and in addition thereto First Party will pay to Second Party such other amounts as may hereafter from time to time be mutually agreed upon between the parties hereto.

Said Second Party as such General Manager shall have full authority to carry on and direct the business and dealings of said corporation, and for that purpose shall have full power to make and enter into contracts for and on behalf of said corporation necessary thereto.

It is further distinctly understood and agreed that the Second Party as such general manager shall be and is hereby authorized and empowered to arrange for and borrow for and on behalf of this corporation at any time during the term of said contract of employment and from time to time such amounts as he [443] as said General Manager may deem desirable and necessary, and upon such terms as he may see fit.

Second Party agrees to render services as General Manager of said corporation upon the terms and conditions above provided and for the term above specified, subject to and provided, however, and the parties do now hereby so agree that said Second Party shall have the right to terminate and cancel this agreement and to resign as such General Manager at any time on and after February 28th, 1942.

Exhibit No. 15—(Continued)

This arrangement will be applicable to the year 1942 and renewable upon the consent of both parties.

Sincerely yours,

MISSION BELL RADIO MFG.
CO., INC.,

By /s/ H. L. HOFFMAN,

HLG:G

President.

EXHIBIT 16

December 16, 1942.

Mr. Walter S. Harmon

3430 South Hill St., Los Angeles, Calif.

Dear Mr. Harmon:

Confirming our verbal agreement, this letter will renew the arrangement we have as of March 10, 1942, covering the salary and override commission of one per cent (1%). This renewal will stay in force for the year 1943 and will be subject to the same terms of renewal as that outlined in our letter of March 10, 1942.

Will you please indicate your acceptance of this program and we will have it filed in the Minutes of our meeting.

Very truly yours,

MISSION BELL RADIO MFG.
CO., INC.,

By /s/ H. L. HOFFMAN,

HLH:ge

President.

Accepted: Walter S. Harmon.

NAME ACCRUED HOFFMAN SALARY

SHEET NO. ONE

215

ADDRESS

OLD BALANCE	DATE	INV. NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE
800 00	2/28		JANUARY 1 1943 BALANCE	800 00		800 00
1600 00	FEB		CHECK REG	800 00		1600 00
156 19	MAR 31 '43		JOURNAL		2056 19	156 19
1749 17	MAR 31 '43		CASH BOOK	2205 36		1749 17
2287 12	MAR 31 '43		JOURNAL		4046 29	2287 12
2577 99	MAR 31 '43		JOURNAL	119 73		2577 99
2596 19	APR 30 '43		JOURNAL		19 06	2596 19
6187 87	APR 30 '43		JOURNAL		4287 42	6187 87
6087 87	MAY 31 '43		JOURNAL	1600 00		6087 87
1287 12	MAY 31 '43		CASH PAYABLE JR		4356 05	1287 12
682 15	JUN 30 '43		JOURNAL	3796 45		682 15
682 15	JUN 30 '43		A/PAY JR	4287 42		682 15
1608 55	JUN 30 '43		JOURNAL		3453 52	1608 55
7008 55	JUN 30 '43		JOURNAL	4355 03		7008 55
7153 52	JUL 31 '43		JOURNAL	3453 52		7153 52
0 00	JUL 31		JOURNAL	3270 76		0 00
3270 76			JOURNAL		2238 35	3270 76
5509 11			JOURNAL	3270 76		5509 11
2238 35			JOURNAL	2238 35		2238 35
0 00			JOURNAL		4676 00	0 00
4676 00			JOURNAL		9496 17	4676 00
9496 17			JOURNAL		5244 80	9496 17
14741 21			JOURNAL	10075 27		14741 21
14741 21			JOURNAL	4666 00		14741 21
0 00			JOURNAL		6333 42	0 00
6333 42			JOURNAL		655 60	6333 42
655 60			JOURNAL	1000 00		655 60
1655 60			JOURNAL	51 20		1655 60
1655 60			JOURNAL		325 00	1655 60
1980 60			JOURNAL	8333 22		1980 60
1980 60			JOURNAL		4007 62	1980 60
5987 82			JOURNAL		2313 20	5987 82
5987 82			JOURNAL			5987 82
6333 42			JOURNAL			6333 42
6333 42			JOURNAL			6333 42

ACCOUNTS RECEIVABLE

SHEET NO.

215

NAME ACCRUED HOFFMAN SALARY

ADDRESS

OLD BALANCE	DATE	INV. NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE
12089 24	DEC 31 '42		BAL FWD			12089 24
0 00	JAN 31 '43	215	ACCTS PAY	12089 24		0 00



ACCOUNTS RECEIVABLE

GENERAL LEDGER

A

NAME ACCRUED HARMON BONUS

SHEET NO. 1

ADDRESS

214

OLD BALANCE	DATE	INV. NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE	
0 00	FEB		JOURNAL		1230 56	1230 56	★
1230 56	MAR 31 '43		JOURNAL		1322 12	2552 68	★
2552 68	MAR 31 '43		JOURNAL		14 24	2566 92	★
2566 92	APR 30 '43		JOURNAL		1430 00	3997 00	★
3997 00	APR 30 '43		CASH PAYABLE	100 00		3897 00	★
3897 00	MAY 31 '43		JOURNAL		1433 41	5330 41	★
5330 41	JUN 30 '43		JOURNAL		1152 91	6483 32	★
6483 32	JUN 30 '43		JOURNAL	5351 21		1132 11	★
1132 11	JUL 31 '43		JOURNAL		1088 06	2220 17	★
2220 17	AUG 31 '43		JOURNAL		742 33	2962 50	★
2962 50	AUG 31 '43		ACCTS PAY	2240 97		721 53	★
721 53	SEP 30 '43		JOURNAL		1549 94	2271 47	★
2271 47	OCT 30 '43		JOURNAL		1604 76	3876 23	★
3876 23	OCT 30 '43		JOURNAL	3897 03		0 00	★
0 00	NOV 30 '43		JOURNAL		2105 74	2105 74	★
2105 74	DEC 31 '43		JOURNAL		2772 34	4878 08	★
4878 08	DEC 31 '43		JOURNAL	2772 34		2105 74	★
2105 74	DEC 31 '43		JOURNAL		1330 47	3436 21	★
3436 21	DEC 31 '43		JOURNAL		771 08	4207 29	★

ACCOUNTS RECEIVABLE

A

NAME ACCRUED HARMON BONUS

SHEET NO.

ADDRESS

214

OLD BALANCE	DATE	INV. NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE	
4207 29	DEC 31 '43	BAL FWD				4207 29	★
	JUN 31 '44	214	ACCTS PAY	4207 29		0 00	★

EXHIBIT 18



EXHIBIT No. 19

Payments Made to Officers

1942

H. L. Hoffman, President.....	\$18,688.52
W. S. Harmon, Vice President.....	7,244.18
R. A. Yarcho, Secretary.....	2,483.25

1943

H. L. Hoffman, President.....	\$63,613.20
W. S. Harmon, Vice President....	22,171.08
R. A. Yarcho, Secretary.....	5,762.26



1943 PAYMENTS - Other than Hourly Employees
 (* Denotes Employed Less Than 12 Months)

NAME	CLASSIFICATION	SALARY	Engring Direction	Engring Material	Indirect Labor	Office	Administrative
Alden, Arthur C.	Stores Supervisor	42,068.61			\$2064.61		
Aldridge, Mattie	Material Control	83.66		\$83.66			
Andrews, Elaine	Clerk Typist	443.99			47.11	8443.99	
Appier, Harvey P.	Expeditor	47.11					
Arnar, R. L., Jr.	Jr. Engineer	653.00	\$653.00				
Arnold, James T.	Commissary Mgr.	1028.16					
Artman, John	Line Foreman	501.90			1628.16		
Azie, Wm. D.	Jr. Engineer	940.89			501.90		
Aze, Jewel P.	Sr. Engineer	4,336.79	4336.79		940.99		
Bauer, Florence	Clerk Typist	574.61				574.61	
Bayntun, E. W.	Line Foreman	1,718.96					
Black, Ruth	De t. Clerk	1,404.75				1404.75	
Braslaw, Robert	Sr. Engineer	412.80			1718.96		
Burley, Georgia E.	Clerk Typist	202.70		202.70			
Carlson, Helen E.	Clerk Typist	538.32				538.32	
Christilaw, John	Line Foreman	2,013.10			2013.10		
Cooper, Frederick W.	Jr. Engineer	937.37	937.37				
Davidge, C. Clifford	(	400.00					
Davidge, Mary M.	{	800.00					
Douglas, Walter D.	1,200.00						
Detstein, Gladyz	2,641.08						
Edwards, E. E.	1,629.48						
Fleming, P. . .	3,839.72						
Forlund, E. F.	Accountant and		3839.72				
	Asst. Treasurer	2,711.45					
Frabo, Donald P.	Accountant B	1,862.01					
Freeman, Ernie R.	Detail Craftsman	1,708.84	1708.84				
* Fuller, E. L.	Sales Engineer	3,370.85	3370.85				
Glatt, Martin L.	Jr. Engineer	1,059.55	1059.55				
Goodall, Edward J.	Line Foreman	221.53					
* Goodear, Raymond	Sr. Engineer	1,342.56	1342.56				
* Gray, George H.	Expeditor	1,208.30					
* Green, Willard J.	Section Engineer	925.31	925.31				
Harnot, W. S.	Vice President	3,900.00	3900.00				
Harris, Leland D.	Jr. Engineer	1,564.62	1564.62				
Hirsch, Betty	FBX Operator	2,122.48					
Ingersoll, Ione	Clerk Typist	80.00					

2130.48
 80.00

1943 PAYMENTS - Other than Hourly Employees
 (* Denotes Employed Less Than 12 Months)

NAME	CLASSIFICATION	SALARY	Engring Direction	FACTORY BURDEN	Material Control	Indirect Labor	Office	Administrative
Alden, Arthur C.	Stores Supervisor	\$2,062.61				\$2004.61		
Aldridge, Mattie	Material Control	83.66		\$83.66			\$443.99	
Andrews, Elaine	Clerk Typist	443.99				47.11		
Appler, Harvey P.	Expeditior	47.11						
Arnor, R. L., Jr.	Jr. Engineer	653.00		\$653.00				
Arnold, James T.	Commissary Mfr.	1026.16						
Artman, John	Line Foreman	501.90				1026.16		
Avis, Wm. D.	Jr. Engineer	940.99				501.90		
Axe, Joel W.	Sr. Engineer	4,336.79		4336.79		940.99		
Bauer, Florence	Clerk Typist	574.61					574.61	
Baynton, E. W.	Line Foreman	1,718.96				1718.96		
Black, Ruth	Dist. Clerk	1,404.75					1404.75	
Bradshaw, Robert	Sr. Engineer	412.50		412.50				
Burles, Georgia K.	Clerk Typist	202.70		202.70				
Carlson, Helen E.	Clerk Typist	532.32					532.32	
Christilas, John	Line Foreman	2,013.10				2013.10		
Cooper, Frederick H.	Jr. Engineer	937.37		937.37				
Davidge, C. Gifford	(400.00	(400.00						
Deavree, Mary M.	(800.00	(800.00						
Deurias, Walter D.	1,200.00	1,200.00						
Eckstein, Olaf W.	2,641.08	2,641.08						
Edwards, E. S.	1,629.48	1,629.48				2641.08		
Fleming, P. . .	Material Control Mfr.	3,839.72		3839.72		1629.48		
Foralund, E. F.	Accountant and Asst. Treasurer	2,771.45					2771.45	
Frab, Donald B.	Accountant B	1,882.01		1882.01				
Freeman, Eraine R.	Detail Draftsman	1,708.84		1708.84				
*Fuller, B. L.	Sales Engineer	3,370.85		3370.85				
Glatt, Martin L.	Jr. Engineer	1,059.55		1059.55				
Goodall, Edward J.	Line Foreman	221.53				221.53		
* Goodear, Edmund	Sr. Engineer	1,342.56		1342.56				
* Gray, George H.	Expeditior	1,708.30						
* Green, Willard J.	Section Engineer	925.31		925.31				
Harnot, W. S.	Vice President	3,900.00		3900.00				
Harris, Leland D.	Jr. Engineer	1,564.62						
Hirsch, Betty	PBX Operator	2,132.48						
Ingersoll, Ione	Clerk Typist	80.00						2132.48 80.00



Name	Classification	Salary	Engineering Direction	Engineering	Material Control	Indirect Labor	Office	Administrative
Johnson, Eugene A.	Drafting	477.26	477.26		1399.66	1584.22		
Johnson, Margaret	Clerk Typist	1,399.66			1682.76	3939.05		
Jones, George W.	Jr. Engineer	1,682.76			2741.89			
Kershner, Edward J.	Expediter	3,939.05			1623.29		2027.94	
Knox, Eugene K.	Line Foreman	2,741.89						
Largher, Steiner G., Jr.	Expediter	2,027.94						
Leadbetter, Lisle E.	Bookkeeper	1,623.29						
LeValley, Lillian K.	Department Clerk	522.12	522.12					
McCaughy, P. P.	Jr. Engineer	1,667.96	1667.96					
*McGinnis, J. Fred	Section Engineer	1,667.96			1002.95			
McKinley, Alice	Prod. Record Clerk	1,602.95						
McMahon, C. J.	Line Foreman	1,273.51						
McNeely, R. J.	Plant Manager	5,168.85						
Maddox, Glenda	Stenographer	2,050.79						
Lois J. Mainord	Clerk Typist	459.00						
*Meador, Howard P.	Draftsman	3,418.43	3418.43					
*Miller, Cyril G.	Section Engineer	3,562.32	3562.32					
Miller, Jay	Department Clerk	554.01						
*Mitchell, Jack M.	Senior Engineer	2,041.88						
Moulton, John C.	Receiving Inspector	2,843.01						
Aberdeck, Doris M.	Typist Clerk	54.00						
O'Connor Ernestine L.	Secretary	113.39						
CVKeefe, John V.	Line Foreman	406.84						
Osborne, Grover H.	Inspector	0.50						
Parkhurst, Albert G.	Junior Engineer	1,029.21						
Payton, Willie J.	Buyer	1,481.95			1481.95			
Pearson, Wesley J.	Jr. Engineer	306.69	306.69					
Peterson, Wilfred H.	Clerk Typist	705.01						
*Pogner, Joseph E.	Senior Engineer	2,865.70						
Pancey, Cleo R.	Clerk Typist	3,350.00						
Perb, Pearl E.	Clerk Typist	301.35						
Reiers, George L.	Jr. & Sr. Engineer	4,407.04						
Reiers, George H.	Line Foreman	2,508.17						
Hollins, Ann	Clerk Typist	95.32						
Reone, Herbert T.	Foreman	147.10						
Sacchetti, Frank J.	Sr. Engineer	362.49						
*Saxon, John E.	Section Engineer	2,143.50						
Salamon, Sophie	Department Clerk	1,836.23						
Sorman, Ella H.	Jr. Engineer	337.50						
					1836.23			

FACTORY BUDGET

Name	Classification	Salary	Engineering Direction	Engineering Control	Material Indirect Labor	Office	Administrative	
Sims, Sam H.	Draftsman	\$1,162.85	\$1162.85					
Snyder, Walter H.	Accountant	1,937.55				\$1937.55		
Solomon, Yvonne	Detail Draftsman	2,636.74	2636.74					
Sprague, Sam L.	Line Foreman	846.89				\$846.89		
Stegedill, Betty	Clerk Typist	1,380.51	1380.51					
Strong, Murie O.	Expeditor	4,593.88	4593.88					
Taylor, Jay L.	Section Engineer	976.97	976.97					
Thiesen, Mary E.	Clerk Typist	665.25						
Thomas, Stuart J.	Foreman	2,106.81				\$2106.81		
Turek, Arlie E.	Department Clerk	2,116.93				2116.93		
Waller, Stacey	Foreman	2,572.88				2572.88		
Walrod, Charles R.	Expeditor	2,701.24				2701.24		
Wess, Rexford	Line Foreman	676.07				676.07		
Yeters, J. R.	Ex editor	2,090.57				2090.57		
* Webster, E. C.	Senior Engineer	2,966.39	2966.39					
* Wiener, Morton	Senior Engineer	2,274.10	2274.10					
Wiener, Paul	Senior Engineer	4,061.93	4061.93					
Willner, Frank E.	Expeditor	730.00						
Winstead, Solomon	Senior Engineer	1,772.60	1772.60			730.00		
Worsh, John S.	Junior Engineer	2,401.40	2401.40					
Yarebo, R. A.	Junior Engineer	5,762.26						
Zobel, Arthur	Engineer	1,222.86						
Harmon, W. S. Bonus		18,271.08	18271.08					
Hoffman, W. L. - Salary and Bonus		\$3,613.20						
TOTAL		\$240,564.96	\$22,171,009.56	744,358	\$1152.99	\$42514.10	\$18809.96	\$69375.46

52

15762.76

63612.20



PAYMENTS TO OFFICERS

Period	Gross Income	Net Income	Dividends Paid	P. L. H. C. W. S.		Sales & Admin. to Gross Income	Sales Commissions	% of Sales & Admin. to Gross Income	Engineer	% of Engineer to Gross Income
				President	Treasurer					
1932	\$ 26,219.55	(\$5,438.83)	\$ 0	\$1,215.00	\$1,215.00	14%	*	14%	*	*
1933	66,975.32	(2,161.67)	0	2,340.00	810.00	8%	*	8%	*	*
1934	115,718.64	667.77	0	5,600.00	0	9.7%	*	9.7%	*	*
1935	176,875.21	2,115.27	0	4,005.00	0	4.5%	*	4.5%	*	*
1936	341,229.86	8,087.97	7,230.00	5,185.00	0	3.2%	570.09	3.2%	2,466.36	.72%
1937	257,277.61	3,702.87	0	5,200.00	0	5%	2,491.96	5%	4,227.00	1.64%
1938	235,525.09	3,624.29	0	5,200.00	0	5.2%	1,843.98	5.2%	4,334.00	1.84%
1939	191,542.31	(8,275.58)	0	5,200.00	0	6.9%	2,714.20	6.9%	4,072.20	2.12%
1940	121,812.16	(11,891.50)	0	5,300.00	4,900.00	9.3%	1,151.98	9.3%	1,759.88	1.44%
1941	29,763.82	(15,470.54)	0	2,364.00	0	8.4%	149.20	8.4%	1,812.50	6.08%

* Records not available for 1932 to 1935, inclusive.

EXHIBIT 21

PAYMENTS TO OFFICERS

Period	Gross Income	Net Income	Dividends Paid	H. L. Hoffman W. S. Harmon R. A. Yareho		% of Sales & Admin. to Gross Income	Sales Commissions	% of Engineer to Gross Income		
				President	Vice President				Secretary	
1942	\$ 351,950.62	\$36,389.06	\$ 0	\$ 18,688.52	(See Engineer)	\$2,485.25	0	6.1%	\$ 7,244.18	2.06%
1943	1,836,432.99	In dispute	0	63,613.20	"	5,762.26	0	3.7%	22,171.08	1.2%



In the United States Court of Appeals
for the Ninth Circuit

The Tax Court of the United States
Docket No. 11683

HOFFMAN RADIO CORPORATION (Formerly
Mission Bell Radio Mfg. Co., Inc.),

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED
STATES

Comes now Hoffman Radio Corporation, the appellant herein, through its counsel of record, and respectfully petitions for a review in the United States Circuit Court of Appeals for the Ninth Circuit of the final decision of The Tax Court of the United States entered on September 22, 1948.

I.

Nature of the Controversy

The controversy involves a determination, under Section 23(a)(1) of the Internal Revenue Code and the regulations and rulings of the appellee promulgated thereunder, of what is a reasonable allowance for the calendar taxable year 1943 for salary or other compensation paid by appellant to H. L. Hoffman, its President and General Manager, for personal services actually rendered.

Under date of May 9, 1946, the Commissioner of Internal Revenue determined deficiencies in the following taxes and amounts against the appellant for the calendar taxable year 1943:

Declared value excess profits tax deficiency	\$1,334.34
Income tax deficiency.....	3,279.24
Excess profits tax deficiency.....	51,331.77

The asserted deficiencies were occasioned by several adjustment to income, only one of which was contested by the appellant, namely, appellee's determination that the appellant, in reporting taxable income for the year 1943, was not entitled to deductions for the following: [456]

\$38,613.20 of the \$63,613.20 compensation for personal services paid to H. L. Hoffman, its President and General Manager.

\$10,171.08 of the \$22,171.08 compensation for personal services paid to W. S. Harmon, its Vice President and Chief Engineer.

The appellant filed a timely appeal with The Tax Court of the United States, and the proceeding was tried in Los Angeles, California, on December 11 and 12, 1947, before the Honorable Richard L. Disney, Judge of The Tax Court of the United States. Under date of June 29, 1948, the Tax Court of the United States entered its Memorandum Findings of Fact and Opinion, and stated that decision would be entered under its Rule 50. The appellee filed a computation for entry of decision under said Rule 50, to which computation the appellant filed its consent, and on September 22, 1948, The Tax Court of the United States entered

its decision that there are deficiencies in the income and excess profits taxes of the appellant for the calendar taxable year 1943 in the respective amounts of \$3,279.24 and \$32,262.38, and that there is no deficiency in the declared value excess-profits tax of the appellant for said year. [457]

The deficiencies in income and excess profits taxes decided by The Tax Court of the United States were based (aside from adjustments to income not at issue before the Tax Court) on the determination that the appellant, in reporting taxable income for the calendar taxable year 1943, was not entitled to a deduction for \$23,613.20 of the \$63,613.20 compensation for personal services paid to H. L. Hoffman, its President and General Manager. Thus, the deficiencies determined by The Tax Court of the United States differ from the deficiencies originally determined by the appellee in that the Tax Court decided that the appellant was entitled to deduct all, instead of only \$12,000.00 as determined by the appellee, of the \$22,171.08 compensation for personal services paid to W. S. Harmon, its Vice President and Chief Engineer, and that it was entitled to deduct \$40,000.00, instead of \$25,000.00 as determined by the appellee, of the \$63,613.20 compensation for personal services paid to H. L. Hoffman, its President and General Manager.

The appellant respectfully submits that under Section 23(a)(1) of the Internal Revenue Code and the regulations and rulings of the appellee promulgated thereunder, a reasonable allowance for the calendar taxable year for salary or other

compensation paid by [458] appellant for personal services actually rendered by H. L. Hoffman, its President and General Manager, is \$63,613.20 instead of \$40,000.00 as determined by The Tax Court of the United States.

II.

The Court in Which Review Is Sought

The United States Circuit Court of Appeals for the Ninth Circuit is the Court in which review of the decision of The Tax Court of the United States is sought pursuant to the provisions of Section 1141 of the Internal Revenue Code.

III.

Venue

The final decision of The Tax Court of the United States was entered on September 22, 1948. The appellant now is, and at all material times has been, a corporation organized under the laws of the State of California, with its principal office and place of business in the County of Los Angeles, State of California, which County is within the Sixth Collection District of California and within the Ninth Judicial Circuit of the United States. The returns of tax of the appellant in respect to which the contested tax liability arises were made to the United States Collector of Internal Revenue for the said Sixth Collection District of California, and the office of said Collector is located at Los Angeles, California, and is within the Ninth Judicial Circuit of the United States.

The appellant and appellee have not stipulated that the said final decision of The Tax Court of the United States may be reviewed by any United States Circuit Court of Appeals other than the one herein designated.

V.

The applicant avers that in the record and proceedings before The Tax Court of the United States, and in the findings of facts, opinion, and decision of said Court, manifest error occurred and intervened to the prejudice of the appellant.

Wherefore, appellant prays that the decision of The Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in [460] accordance with the law and the rules of, or governing, said Courts, and be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit for filing; and that appropriate action be taken that the errors complained of may be reviewed and corrected by said Circuit Court of Appeals.

Dated November 18, 1948.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS,
Counsel for Appellant.

Of Counsel:

/s/ L. A. LUCE,

[Endorsed]: T.C.U.S. Filed Nov. 30, 1948.

The Tax Court of the United States

[Title of Cause.]

NOTICE OF FILING OF PETITION
FOR REVIEW

To: Hon. Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that the petitioner on the 30th day of November, 1948, filed with the Clerk of The Tax Court of the United States at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court of the United States entered on September 22, 1948, in the above-entitled proceeding; and a copy of said petition for review, as filed, is [462] attached hereto and served upon you with the service of this notice.

Dated Nov. 30, 1948.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS,
Counsel for Petitioner.

Of Counsel:

/s/ L. A. LUCE,

[Acknowledgment of Service.) [463]

[Endorsed]: T.C.U.S. Filed Nov. 30, 1948.

[Title of Tax Court and Cause.]

MOTION FOR ORDER DIRECTING TRANSMISSION OF EXHIBITS IN ORIGINAL FORM ON APPEAL

Comes now Hoffman Radio Corporation, the petitioner herein, through its counsel of record, and respectfully moves as follows:

Whereas, the petitioner has filed a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the Decision entered on September 22, 1948, by The Tax Court of the United States in the above-entitled proceedings; and

Whereas, the petitioner will designate for inclusion in the record on review in this cause the following among other things: [464]

1. The Stipulation of Facts filed on December 11, 1947, together with Exhibits 1 to 22, both inclusive, attached thereto.

2. Petitioner's Exhibits 1 to 5, both inclusive, filed at the hearing.

3. Respondent's Exhibits A to G, both inclusive, filed at the hearing, but excluding Exhibit H not introduced into evidence; and

Whereas, the petitioner submits that it will serve the ends of economy and practicality in the preparation of the records on review, and materially accelerate the progress of the appeal, if this Honorable Court would enter an order in conformity

with Rule 75 in the Federal Rules of Civil Procedure that the above-mentioned stipulations and exhibits should be transmitted in their original form to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit;

Now, Therefore, petitioner respectfully moves that an order be entered by this Honorable Court directing that the stipulations and exhibits hereinbefore set forth be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit in their original form with the record on review in this cause, and containing such further directions regarding the safekeeping, [465] transportation, and return thereof as this Honorable Court shall deem proper.

Dated Nov. 30, 1948.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS,
Counsel for Petitioner.

Of Counsel:

/s/ L. A. LUCE. [466]

[Endorsed]: T.C.U.S. Filed December 16, 1948.

The petitioner avers that The Tax Court of the United States erred: [468]

(A) In finding and determining that there are deficiencies in the income and excess profits taxes of the petitioner for the calendar taxable year 1943 by reason of the disallowances as a deduction, in computing taxable income of \$23,613.20 of the \$63,613.20 compensation for personal services actually rendered, paid by petitioner to H. L. Hoffman, its President and General Manager, in 1943.

(B) In failing to find and decide that, within the meaning of Section 23(a)(1)(A) of the Internal Revenue Code, a reasonable allowance for salary and contingent compensation for personal services actually rendered, paid by petitioner in 1943 to H. L. Hoffman, its President and General Manager, under a contract dated December 4, 1941, was at least \$63,613.20.

(C) In finding and deciding, without any evidence or substantial evidence in support thereof, that reasonable compensation for services performed by H. L. Hoffman, the President and General Manager of the petitioner, for the year 1943 was only \$40,000.00.

(D) In misinterpreting and failing to give proper legal effect to Section 29.23(a)-6 of United States Treasury Department Regulations 111. [469]

(E) In disregarding the rule, established by Section 29.23(a)-6 of United States Treasury Department Regulations 111 and settled court decisions, that under Section 23(a)(1)(A) of the Internal Revenue Code, in determining a reasonable allowance for compensation paid, the circumstances

to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

(F) In finding and deciding, without any evidence or substantial evidence in support thereof, that the contract of employment, dated December 4, 1941, between the petitioner and H. L. Hoffman, was not the result of a free bargain between the parties to secure the services of Hoffman; and in failing to find and decide that said contract was the result of a free bargain between the parties to secure the services of Hoffman.

(G) In failing to give proper legal effect to the fact that, in the case of a contingent compensation contract based on a percentage of the employer's gross sales where the business and fiscal activities of the employer overlap several calendar years, as are the facts found in this proceedings, the compensation [470] paid the employee for any one year is in part compensation for personal services rendered by the employee in prior years as well as the year of payment.

(H) In disregarding the unimpeached testimony of qualified and competent expert witnesses that the compensation of \$63,613.20 paid by petitioner to H. L. Hoffman in 1943 was reasonable.

(I) In misinterpreting and failing to give proper legal effect to the evidence of compensation paid for like services by like enterprises under like circumstances, in accordance with the rule established by Section 29.23(a)-6 of United States Treas-

ury Department Regulations 111 and settled court decisions.

II. Designation of Contents of Record on Review.

The petitioner designates for inclusion in the record on review in this proceeding the following:

The complete record of all the proceedings and evidence taken before The Tax Court of the United States and all matters required to be included therein by Rule 75(g) of the Federal Rules of Civil Procedure, giving effect, when possible, to the admonitions of Rule 75(e) of the Federal Rules of Civil Procedure, and including the following: [471]

(A) Docket entries of all the proceedings before The Tax Court of the United States.

(B) The pleadings, including the Petition of the petitioner, together with the annexed copy of the statutory deficiency notice, and the Answer of the respondent.

(C) The Memorandum Findings of Fact and Opinion entered June 29, 1948.

(D) The Decision entered September 22, 1948.

(E) The Official Report of Proceedings, pages 1 to 342, both inclusive.

(F) The Stipulation of Facts filed on December 11, 1947, together with Exhibits 1 to 22, both inclusive, attached thereto.

(G) Petitioner's Exhibits 1 to 5, both inclusive, filed at the hearing.

(H) Respondent's Exhibits A to G, both inclusive, filed at the hearing, but excluding Exhibit H, not introduced into evidence.

(I) The Petition for Review of Decision of the Tax Court of the United States.

(J) The Notice of Filing of Petition for Review, together with proof of service thereof and service of the annexed copy of the Petition for Review. [472]

(K) The Motion, together with proof of service thereof, and the Order re transmission of documents in original form.

(L) This document, together with proof of service thereof.

Dated Nov. 30, 1948.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS,
Counsel for Petitioner.

Of Counsel:

/s/ L. A. LUCE,

(Acknowledgment of Service.) [473]

[Endorsed]: T.C.U.S. Filed Dec. 16, 1948.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 474, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as

In the United States Court of Appeals for the
Ninth Circuit

No. 12144

HOFFMAN RADIO CORPORATION, (Formerly Mission Bell Radio Mfg. Co., Inc.),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

MOTION FOR ENLARGEMENT OF TIME
FOR THE PREPARATION, TRANSMISSION AND FILING OF THE RECORD
UPON PETITION FOR REVIEW

Comes now Hoffman Radio Corporation, the Petitioner on review in the above-entitled cause, by and through its counsel of record and moves that the time for the preparation, transmission and filing in this Honorable Court of the record upon Petition for Review by the Clerk of the Tax Court of the United States be enlarged by a period of thirty days or until February 8, 1949.

In support of this motion, the Petitioner states the following facts and submits the attached affidavit.

The Petition for Review in this cause was filed with The Tax Court of the United States on November 30, 1948, and the time for preparing and transmitting the record by the Clerk of The Tax Court of the United States will expire on January 9, 1949. No previous extension of time has been

granted. Owing to the necessity of obtaining an agreement between the parties as to the contents of the record and the voluminous nature of the record which must be prepared, the Clerk of The Tax Court will not be able to complete and transmit the record by January 9, 1949.

Wherefore, the Petitioner respectfully requests the Court to order, pursuant the Rules 13 and 31 (3) of the Court, that the time to prepare, transmit and file the record in this cause be enlarged to February 8, 1949.

Dated this 21st day of December, 1948.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS.

[Endorsed]: T.C.U.S. Filed Dec. 29, 1948.

[Endorsed]: Filed January 4, 1949. Paul P. O'Brien, Clerk.

AFFIDAVIT IN SUPPORT OF MOTION FOR ENLARGEMENT OF TIME

County of Los Angeles,
State of California—ss.

Harrison Harkins, being first duly sworn, deposed and says:

That he is one of counsel for the Hoffman Radio Corporation, and that on November 30, 1948, said corporation filed with the Clerk of the Tax Court of the United States a Petition for Review wherein and whereby the said corporation petitioned the Review wherein and whereby the said corporation petitioned the United States Court of Appeals for

the Ninth Circuit to review the decision of the Tax Court of the United States in the cause of Hoffman Radio Corporation v. Commissioner of Internal Revenue, Tax Court Docket No. 11683;

That counsel for said petitioner forthwith sought to obtain an agreement with counsel for the respondent in said cause as to the contents of the record on appeal, but such agreement was not reached and the designation of record was not filed until December 16, 1948;

That the record on appeal is voluminous;

That the affiant is informed and believes, and on that ground states, that due to the facts recited herein the Clerk of The Tax Court of the United States will not be able to complete, transmit and file the record on appeal by January 9, 1949;

That no previous enlargement of time has been ordered in said cause.

/s/ HARRISON HARKINS.

Subscribed and sworn to before me this 21st day of December, 1948.

[Seal] PEARL ANDERSON,

Notary Public in and for said County and State.
My commission expires on Sept. 3, 1950.

Ordered Time Extended as Prayed for.

(Seal) /s/ WILLIAM DENMAN,
Chief Judge, U. S. Court of Appeals for the Ninth District.

A true copy. Attest: Dec. 23, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed December 23, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

APPELLANT'S STATEMENT OF ERRORS
RELIED UPON AND DESIGNATION OF
PARTS OF THE RECORD TO BE
PRINTED

Comes now Hoffman Radio Corporation, the appellant, by and through its counsel of record, and states the following:

I. Statement of Errors Relied Upon.

The appellant avers that in the record and proceedings before The Tax Court of the United States and in the opinion, findings of fact, and decision rendered by said Court, manifest error occurred and intervened to the prejudice of the appellant, who now assigns the following points on which appellant intends to rely in this proceeding:

The Tax Court of the United States erred:

(A) In finding and determining that there are deficiencies in the income and excess profits taxes of the appellant for the calendar taxable year 1943 by reason of the disallowance as a deduction, in computing taxable income, of \$23,613.20 of the \$63,613.20 compensation for personal services actually rendered, paid by appellant to H. L. Hoffman, its President and General Manager, in 1943.

(B) In failing to find and decide that, within the meaning of Section 23(a)(1)(A) of the Internal Revenue Code, a reasonable allowance for salary and contingent compensation for personal services actually rendered, paid by appellant in

1943 to H. L. Hoffman, its President and General Manager, under a contract dated December 4, 1941, was at least \$63,613.20.

(C) In finding and deciding, without any evidence or substantial evidence in support thereof, that reasonable compensation for services performed by H. I. Hoffman, the President and General Manager of the appellant, for the year 1943 was only \$40,000.00.

(D) In misinterpreting and failing to give proper legal effect to Section 29.23(a)-6 of United States Treasury Department Regulations 111, in that the Court did not apply the rule laid down in said regulation that in considering the question of a reasonable allowance for compensation paid pursuant to a pre-existing contract, the circumstances to be considered are those existing at the date when the contract for services were made, not those existing at the date when the contract is questioned; and if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration upon the part of the employer other than that of securing in fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(E) In disregarding the rule, established by Section 29.23(a)-6 of United States Treasury Department Regulations 111 and settled court decisions, that, under Section 23(a)(1)(A) of the In-

ternal Revenue Code, in determining a reasonable allowance for compensation paid, the circumstances to be taken into account are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

(F) In finding and deciding, without any evidence or substantial evidence in support thereof, that the contract of employment between the appellant and H. L. Hoffman, dated December 4, 1941, was not the result of a free bargain between the parties to secure the services of Hoffman; and in failing to find and decide that said contract was the result of a free bargain between the parties to secure the services of Hoffman.

(G) In failing to give proper legal effect to the fact that, in the case of a contingent compensation contract based on a percentage of the employer's gross sales where the business and fiscal activities of the employer overlap several calendar years, as are the facts found in this proceeding, the compensation paid the employee for any one year is in part compensation for personal services rendered by the employee in prior years as well as the year of payment.

(H) In disregarding the unimpeached testimony of the qualified and competent expert witnesses, John H. Clippinger, James H. Tuttle, and S. W. Gilfillan, that the compensation of \$63,613.20 paid by the appellant to H. L. Hoffman in 1943 was reasonable.

(I) In misinterpreting and failing to give proper legal effect to the evidence of compensa-

tion paid for like services by like enterprises (Admiral Corporation and Gilfillan Bros., Inc.) under like circumstances, in accordance with the rule established by Section 29.23(a)-6 of United States Treasury Department Regulations 111 and settled court decisions.

II. Designation of Parts of the Record to Be Printed.

Appellant designates the entire record, as certified to this Honorable Court by Clerk of The Tax Court of the United States inclusive of the Original Exhibits, as necessary to be printed for the consideration of the points set forth above. Petitioner also designates this statement of errors and designation, together with proof of service thereof, as necessary to be printed.

Dated January 6, 1949.

/s/ CLAUDE I. PARKER,
/s/ JOHN B. MILLIKEN,
/s/ RALPH KOHLMEIER,
/s/ HARRISON HARKINS,
Counsel for Appellant.

Of Counsel:

/s/ L. A. LUCE,

[Endorsed]: Filed January 7, 1949. Paul P. O'Brien, Clerk.

No. 12,144

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

HOFFMAN RADIO CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER.

With Appendix.

**Petition to Review a Decision of the Tax Court of the
United States**

CLAUDE I. PARKER,
JOHN B. MILLIKEN,
RALPH KOHLMEIER,
HARRISON HARKINS,

650 South Spring Street, Los Angeles 14.

Counsel for Petitioner.

Of Counsel:

L. A. LUCE.

FILED

APR 12 1949

PAUL P. O'BRIEN,

CLERK



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No. 12,144

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HOFFMAN RADIO CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER.

With Appendix.

Opinion Below.

The only opinion in this case is the Memorandum Findings of Fact and Opinion of the Tax Court of the United States, Docket No. 11683, entered June 29, 1948 [R. 21-46], which is not officially reported.

Jurisdiction.

This proceeding involves a deficiency assessment of Federal Income Tax and Excess Profits Tax for the Petitioner's calendar taxable year 1943 [R. 47]. On May 9, 1946, and pursuant to Sections 272, 600, and 729 of the *Internal Revenue Code*, the Respondent mailed to Petitioner his statutory notice of determination of deficiencies in Petitioner's income, declared value excess-profits, and excess profits taxes for the taxable year 1943 [R. 9-19]. Within the time provided in Section 272 of the

Internal Revenue Code and on July 31, 1946, the Petitioner filed a petition with the Tax Court of the United States for a redetermination of the asserted deficiencies in taxes [R. 1]. Jurisdiction was conferred on the Tax Court by Sections 1100, 1101, 272, 600, and 729 of the *Internal Revenue Code*. The decision of the Tax Court of the United States was entered on September 22, 1948 [R. 47]. Within three months and on November 30, 1948, a petition for review by your Honorable Court was filed with the Tax Court [R. 551-555], pursuant to the provisions of Section 1142 of the *Internal Revenue Code*. Jurisdiction is conferred on your Honorable Court by Section 1141 of the *Internal Revenue Code*.

Statement of the Case.

This proceeding is on petition to review a decision of the Tax Court of the United States, which determined Federal tax deficiencies against the Petitioner for its calendar taxable year 1943 in the amounts of \$3,279.24 in Income Tax and \$32,262.38 in Excess Profits Tax. The question for review is—Under Section 23(a)(1)(A) of the *Internal Revenue Code*, what amount of deduction is reasonably allowable to Petitioner for salary or other compensation for personal services paid or incurred in 1943 to H. L. Hoffman, the Petitioner's President and General Manager, pursuant to an employment contract executed on December 4, 1941? The entire record has been brought up for review.

On its tax return for 1943, the Petitioner claimed a deduction for \$63,613.20, the amount incurred or paid by it to Mr. Hoffman pursuant to the employment contract; but the Respondent, in his statutory notice of deficiency, determined that only \$25,000.00 was allowable as a deduction for tax purposes. The Petitioner petitioned the

Tax Court to reconsider the Respondent's deficiency assessment, and the Tax Court determined that \$40,000.00 of the \$63,613.20 compensation was an allowable deduction. In this proceeding for review of the Tax Court decision, the Petitioner still claims that it is entitled to deduct the full amount of the \$63,613.20 compensation incurred or paid by it to Mr. Hoffman in 1943 pursuant to the employment contract, executed on December 4, 1941, which was in force during the taxable year at issue. Should your Honorable Court decide in favor of the Petitioner, the excess profits tax deficiency will be reduced by approximately \$18,890.56, but the income tax deficiency will remain the same.

Statute, Regulations, and Rulings Involved.

The statute involved is Section 23(a)(1)(A) of the *Internal Revenue Code* which, in material part, reads as follows:

“SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered: * * *”

The regulations and rulings involved are lengthy, and for convenience are set forth in the Appendix to this brief.

Specifications of Error.

The Tax Court of the United States erred:

1. In failing to find, conclude, and hold that the \$63,613.20 incurred or paid by the Petitioner to H. L. Hoffman in 1943, pursuant to an employment contract executed on December 4, 1941, was in its entirety a reasonable allowance for salary or other compensation for personal services actually rendered, within the meaning of Section 23(a)(1)(A) of the *Internal Revenue Code* [see Appendix, *infra*].

2. In finding, concluding, and holding that "Reasonable compensation for services performed by Hoffman as president and general manager of petitioner for the year 1943 was \$40,000.00" [R. 38], instead of \$63,613.20.

3. In failing to find, conclude, and hold that, within the meaning of Section 29.23(a)-6 of *United States Treasury Department Regulations 111* [see Appendix, *infra*], the employment contract between Petitioner and H. L. Hoffman, executed on December 4, 1941, was the result of a free bargain between the parties, made before the services were rendered, and which was not influenced by any consideration upon the part of the Petitioner other than that of securing the services of Mr. Hoffman on fair and advantageous terms.

4. In finding, concluding, and holding, with respect to the December 4, 1941, employment contract between the Petitioner and H. L. Hoffman that "there was not in this matter the free bargaining and arm's length transaction,

between a corporation and a proposed employee for services on a contingent basis, with which, under the regulation, there should not be interference" [R. 44].

5. In failing to find, conclude, and hold, within the meaning of Section 29.23(a)-6 of *United States Treasury Department Regulations 111* [see Appendix, *infra*], that in determining a reasonable allowance for contingent compensation incurred or paid in 1943 by the Petitioner to H. L. Hoffman pursuant to a contract executed on December 4, 1941, the circumstances to be considered in determining reasonableness are those which existed at December 4, 1941, the date the contingent compensation contract was executed, not those existing in 1943, the date when the deduction of the contingent compensation incurred or paid pursuant to the preexisting contract was questioned.

6. In failing to give proper effect to the finding "that petitioner's business activities were in poor condition at the time Hoffman closed the negotiations for acquiring stock and management control of it and that a great part of the success of the venture was due to his efforts" [R. 44-45].

7. In failing to find, conclude, and hold that in the case of preexisting contingent compensation contract, based on a percentage of the employer's gross sales, where the business and fiscal operations of the employer are growing in volume and overlap several calendar and accounting years, as are the facts in the case at issue, the contingent compensation incurred or paid to the employee

for any one year is, in part, necessarily compensation for services rendered by the employee in prior years as well as for the year of payment.

8. In failing to find, conclude, and hold in accordance with the unimpeached testimony of the qualified and competent expert witnesses, John H. Clippinger, James H. Tuttle, and S. W. Gilfillan that the compensation of \$63,613.20 incurred or paid by Petitioner to H. L. Hoffman in 1943 was a reasonable compensation.

9. In misinterpreting and failing to give proper effect to the evidence of compensation paid for like services by like enterprises under like circumstances (Admiral Corporation, Gilfillan Bros., Inc., and commissions paid Washington representatives) in determining the reasonableness of the compensation incurred or paid by the Petitioner to H. L. Hoffman in 1943.

ARGUMENT.

I.

Summary of Argument.

The Petitioner emphasizes at the outset of its argument that it is not presenting to your Honorable Court the simple plea that, in view of the recent statutory enactment relaxing the rule on review of Tax Court decisions (*Internal Revenue Code*, Section 1141(a), as amended by Section 36, Public Law 773, 80th Congress, Second Session), your Honorable Court should scan the record and decide, as a matter of fact, that \$63,612.20, rather than \$40,000.00, is a reasonable allowance for compensation paid by Petitioner to its President and General Manager in 1943. On the contrary, the Petitioner's principal contention in this proceeding is that, as a matter of law, the full compensation paid by Petitioner in 1943 must be allowed as a deduction since it was paid pursuant to a preexisting contract, which contract, executed in 1941, was fair and reasonable in the light of the circumstances attending its execution; and the Treasury Department Regulation (*Reg. 111*, Sec. 29.23(a)-6(3)), which has acquired the force and effect of law by reason of the repeated reenactment of the statutory provision it interprets, specifically and definitely provides that in determining the reasonableness of a compensation allowance "The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned."

If, however, your Honorable Court should decide that the judicial scrutiny of the case properly covers the period subsequent to the date of execution of the employment contract, the Petitioner contends, both as a matter of

law and a matter of fact, that the record clearly shows that the compensation paid by Petitioner in 1943 to H. L. Hoffman was reasonable in relation to the services actually rendered by the man.

II.

The Tax Court Clearly Erred in Concluding That the December 4, 1941, Contingent Compensation Employment Contract Between the Petitioner and H. L. Hoffman Was Not a Fair and Advantageous Contract Resulting From a Free Bargain and an Arm's Length Transaction.

In its "Opinion," as distinguished from its formal "Findings of Fact," the Tax Court of the United States concluded that "there was not in this matter the free bargaining and arm's length transaction, between a corporation and a proposed employee for services on a contingent basis, with which, under the regulations, there should not be interference" [R. 44]. The "regulations" referred to by the Court are *United States Treasury Department Regulations 111*, Sec. 29.23(a)-6(2) [see Appendix], which read in part as follows:

"Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid."

The Petitioner submits that the finding of the Tax Court on this basic point is a clearly erroneous conclusion in the light of the following facts of record:

(a) As of December 4, 1941, the date of the employment contract [R. 539-541] between the Petitioner and H. L. Hoffman, and the date Hoffman first became associated with the Petitioner, the Petitioner's physical plant and inventory was obsolete and in sorry shape; it had no production staff and its production activities were at a standstill; there was internal dissention in its management; it was in financial difficulties; it had a poor reputation in its industry, the radio industry; it had lost its principal sales account and had no firm future prospects; it was delinquent in its payment of salary to its then President; and it was in no position to employ Hoffman on a fixed compensation basis. [R. 22-25, 31, 33, 44, 68-71, 76-77, 80, 83, 130-132, 134-136, 164-165, 178, 193-195, 200, 213-214, 235, 246, 270-271, 275-277, 278-281, 348-349, 490, 499, 507-508, 521, 527-530.]

(b) Contingent compensation employment contracts such as that executed by Petitioner and H. L. Hoffman [R. 539-541] were well known in the radio industry generally; and were known and availed of in the then current employment histories of both the Petitioner and H. L. Hoffman. At the time Hoffman became President and General Manager of the Petitioner, the Petitioner had a contingent compensation contract with its then President, P. L. Fleming, calling for the payment of 5% on sales made by him, and it had in force two other contingent contracts with agents calling for the payment of 5% and 3% respectively on business obtained or sales made by the agents. [R. 199-200, 205-206, 80-82, 101-102, 66-67, 76-77, 83, 212-214, 275-277.]

(c) H. L. Hoffman was not in stock control nor management control of the Petitioner at the time the parties executed the contingent employment contract at issue [R. 539-541], nor was he in such control before or after that date; and the Petitioner's contract with Hoffman was agreed to and approved before its formal execution (either by written approval or by vote at the directors' meeting) by every retiring and every new stockholder, director, and officer of the Petitioner. [R. 26-31, 32-33, 76-80, 137-139, 148-149, 270-278, 346, 495, 500-502, 510-512, 517-525, 526, 531-535, 537, 539-541.]

(d) Three disinterested and qualified witnesses, who were either present or past officers or employees of competitors of the Petitioner, and one of whom (S. W. Gillfillan, the President of a competitor of the Petitioner) was originally called as the Respondent's witness, gave unimpeached testimony that the contingent compensation contract between the Petitioner and Hoffman [R. 539-541]. was a fair and reasonable contract, from the point of view of the Petitioner, in the light of the circumstances attending its execution. [R. 177-182, 193-196, 197-198, 200-204, 314-324, 275-278.]

It may be that counsel suffers from that form of myopia common to advocates for petitioners on review, but it is difficult to see any justification in the record in this proceeding for the conclusion of the Tax Court that the employment contract between the Petitioner and Hoffman was not the result of a free bargain. Certainly the only reason stated by the Tax Court for its conclusion [R. 44] is in error and in conflict with the findings previously made by it. [R. 26-27.] That is, the Tax Court gave as the basis for its conclusion the following [R. 44]:

“Hoffman, at the time he contracted with the petitioner corporation itself, for the contingent salary

here involved, was the owner of 110 of the 413 shares of stock, and a director, and had a contract for the purchase of the remainder of the stock. Also, he had a contract with the other individual stockholders, the Warners and Fleming (as with Schmieter from whom he had acquired the 110 shares), that he be made general manager on a basis of 3 per cent of gross sales. The contract for purchase of the Warner and Fleming stock was consummated on December 4, 1941, immediately after Hoffman's employment as general manager. All of this means to us that there was not in this matter . . . free bargaining . . ."

The Petitioner submits that there are at least two defects in the Tax Court's reasoning on this point. First: Granting that the "petitioner corporation itself" is a legal entity separate from its stockholders, directors, and officers; yet the Tax Court overlooks the fact that this legal entity, "the petitioner corporation itself," can act and *bargain* only through its stockholders, directors, and officers, and that the unanimous act and bargain of all of its stockholders, when formally carried into effect by the unanimous vote of its directors approving the bargain, and the act of the officers in signing the bargain pursuant to the directors' resolution, is necessarily the act and *bargain* of the corporation itself. Second: The stated reasoning of the Tax Court, with its implied sinister emphasis on the fact that *Hoffman* had purchased or agreed to purchase all of the Petitioner's stock, overlooks the point of its previous detailed finding [R. 26-27] that prior to the drafting, much less the execution, of any of the formal documents involved in this case. Hoffman, Davidge, and Douglas (the prospective officers, directors, and stockholders of Petitioner during the term of Hoffman's employment contract) had agreed that Hoffman

should act in acquiring the stock of Petitioner as *trustee* for himself, Davidge, and Douglas in the respective beneficial interests of 50, 25, and 25 per cent; that the three men had agreed upon the terms and procedures for acquiring stock and management control of Petitioner; and that the three men had bargained and agreed upon the terms of Hoffman's employment contract.

The Petitioner submits that, based on realities and substance, the correct analysis of this phase of the matter is as follows: The Petitioner, a corporation, is a legal entity separate from its stockholders, directors, and officers, but it necessarily must act and bargain through its stockholders, directors, and officers. By a preliminary agreement, later in fact carried into effect, Hoffman, Davidge, and Douglas were destined to be, and were in fact, the stockholders, directors, and officers of the Petitioner during the entire term of the Hoffman employment contract. [R. 26-27.] It should follow, therefore, that if the terms of Hoffman's employment contract was arrived at by a free bargain between these three men, and if that bargain was given formal expression by a resolution duly adopted by the directors of the Petitioner, and the act of its officers in executing the formal document of employment pursuant to said resolution, the contract must necessarily represent the free bargain of the Petitioner. In fact, the Hoffman employment contract was arrived at by a free bargain between Hoffman, Davidge, and Douglas. [R. 26-27, 76-80, 148-149, 270-279, 517-525.] On the advice of Mr. Davidge's attorney [R. 148-149, 270-272], the contract was approved by the outgoing stockholders and

directors of the Petitioner [R. 495, 500-502, 510-512, 531-535], and pursuant to the resolution of the directors [R. 531-535] the outgoing officers of the Petitioner executed the formal employment contract. [R. 539-541.] Further, the Hoffman contract was impliedly ratified by the new directors of Petitioner, in that the new directors, on May 14, 1942, resolved that under the contract, the fixed portion of Hoffman's compensation should be \$800.00 a month. [R. 535-538.] Since the Hoffman contract was approved by every retiring or new stockholder, director, and officer of the Petitioner (Schmieter, the Warners, Fleming, M. E. Penny, Hoffman, Douglas, and Davidge) and since none of these people were acting under the compulsion of Hoffman, it must follow that the Hoffman employment contract is a product of a free bargain by the Petitioner. This conclusion is substantiated by the unimpeached testimony of officers or employees of competitors of the Petitioner (including the President of a competitor originally called as a witness by the Respondent) who testified that the Hoffman contract was very fair and reasonable one from the point of view of the Petitioner. [R. 177-182, 193-196, 200-204, 314-324.]

The Petitioner submits that the last factor mentioned is in itself a sufficient ground for the overthrow of the determination of the Tax Court on this point. That is, your Honorable Court has stated that "It is axiomatic that uncontradicted testimony must be followed," unless the witness is impeached or the testimony is improbable. (*Grace Bros., Inc. v. Commissioner of Internal Revenue* (9 Cir., Feb. 18, 1949), F. 2d) In a case involving the

reasonableness of compensation paid, the Court of Appeals for the Sixth Circuit in *Roth Office Equipment Company v. Gallagher* (6 Cir., Feb. 10, 1949), 172 F. 2d 452, restated the axiom in a manner which justifies an extended quotation, as follows:

“No witness testified that the amounts found by the District Court as reasonable compensation in 1942 was the reasonable compensation to which the officers were entitled. The only direct evidence before the Court on the specific question of reasonableness of compensation was the testimony of Harold Hampton and Archie Shearer, both well-qualified, impartial witnesses, with many years of experience. They testified that in their opinion the compensation was reasonable . . . The credibility of these witnesses was not put in issue. The appellee offered no witness to contradict this testimony or to testify in any way that the compensation was unreasonable to any extent. On this crucial and single issue of fact in this case this unimpeached, uncontradicted testimony from well-qualified, impartial witnesses cannot be disregarded by the Court. This Court has several times stated that such testimony should be accepted by the fact-finder in a matter in which the fact-finder has no knowledge or experience upon which he could exercise an independent judgment (citing cases). As was pointed out in *T. P. Taylor & Co. v. Glenn*, 62 Fed. Supp. 495, 499, W. D. Ky., if the compensation paid is unreasonable the appellee certainly could have produced some experienced witness from the industry who could have said so, and the failure to offer such a witness on the crucial issue in the case operates very strongly against his contention. The burden of proof in cases of this kind is upon the taxpayer, but we are of the opinion that that burden has been met when the taxpayer introduces uncontradicted, unim-

peached testimony from well-qualified, impartial witnesses sustaining its contention, unless the established facts themselves are such as to show that such testimony ought to not to be accepted.”

In the instant matter, not only has Petitioner produced unimpeached evidence that the Hoffman employment contract was a fair and advantageous one to the Petitioner, and not only has the Respondent failed to produce contrary evidence, but the Respondent’s own witness, Mr. Gilfillan, testified that the contract “was a good contract for the corporation” [R. 323] and was “Fair and equitable.” [R. 324.] The Tax Court accepted the testimony of this witness [R. 297-344] as the basis of some of its formal findings of fact [R. 38], and it is submitted that it was required to accept his unimpeached testimony on the initial reasonableness of the Hoffman employment contract. And the same conclusion applies to the unimpeached testimony of John H. Clippinger and James M. Tuttle. Mr. Clippinger testified that the compensation stated in the Hoffman contract represented a fair and reasonable compensation [R. 182], and the Tax Court accepted other testimony of this man [R. 174-198] as the basis of some of its findings of fact. [R. 37.] Mr. Tuttle characterized the employment contract as “Most reasonable.” [R. 202.]

In concluding this phase of its argument, the Petitioner submits that the record compels the conclusion that the Hoffman employment contract was a fair and advantageous contract to the Petitioner, which was arrived at as the result of a free bargain and an arm’s length transaction.

III.

Section 29.23(a)-6 of United States Treasury Department Regulations 111 Has Acquired the Force and Effect of Law, and Under the Language of This Regulation the Compensation Paid by Petitioner to H. L. Hoffman in 1943 Pursuant to the Contract Executed December 4, 1941, Must Be Allowed as a Deduction.

The statutory provision involved in this proceeding, *Internal Revenue Code* Section 23(a)(1)(A) [see Appendix], authorizes the deduction of “a *reasonable* allowance for salaries or other compensation paid for services actually rendered” (italics supplied). It is an established rule that a statutory provision using such a general word as “reasonable” is peculiarly needful of an administrative regulation interpreting it. (*Helvering v. Wilshire Oil Company*, 308 U. S. 90, at 101-102, 84 L. Ed. 101, 60 S. Ct. 18); and in this instance the applicable regulation is Section 29.23(a)-6 of *United States Treasury Department Regulations 111*. This regulation has a long history in tax law, and in fact the original administrative ruling on the subject preceded the original statutory enactment by about a year, which is compelling evidence that the administrative ruling correctly reflects the Congressional intent. That is, the *Revenue Act of 1916* (Act of September 8, 1916, 39 Stat. 756, as amended) did not contain the specific provision for the deduction of a “reasonable allowance for salaries or other compensation,” but simply provided for the deduction of “all the ordinary and necessary expenses paid” [see Appendix]. In order to apply this latter provision, the Treasury Department, on

April 10, 1918, issued *Treasury Decision 2696* (Vol. 20 *Treasury Decisions* (Government Printing Office, 1919), page 330) [see Appendix], which, among other things, laid down the following rules:

“Compensation on whatever basis fixed, representing only the price paid for services pursuant to a fair bargain made in advance between the individual and the business enterprise, is deductible in determining the taxable net income of the enterprise.”

“In the case of compensation fixed after services are rendered and not in accordance with any contract or custom or practice amounting virtually to a contract, reasonableness is ordinarily the controlling test of deductibility.”

This then was the state of the law and the administrative interpretation thereof on February 24, 1919, the date the *Revenue Act of 1918* (Act of February 24, 1919, 40 Stat. 1057) became effective; and the *Revenue Act of 1918* (Subsection 234(a)(1)) is the first act to specifically provide for a deduction of “a reasonable allowance for salaries or other compensation for personal services actually rendered.” It is logical to assume that the statutory provision was and is the embodiment of the administrative ruling, for the statutory provision and the administrative ruling have had the following histories—

Statutory history: The quoted provision of Subsection 234(a)(1) of the *Revenue Act of 1918* was reenacted as Subsection 234(a)(1) of the *Revenue Acts of 1921, 1924, and 1926*; as Subsection 23(a) of the *Revenue Acts of 1928, 1932, 1934, and 1936*; as Subsection 23(a)(1) of the *Revenue Act of 1938*; and as Subsection 23(a)(1)(A) of the *Internal Revenue Code*.

Administrative ruling history: The provisions of *Treasury Decision 2696* [see Appendix], or provisions essentially and substantially similar to it, have been in force as Article 105 of *Regulations 45* (1918-19-20), Art. 105, *Reg. 62* (1921-22-23), Art. 106, *Reg. 65* (1924), Art. 106, *Reg. 69* (1926), Art. 126, *Reg. 74* (1928), Art. 126, *Reg. 77* (1932), Art. 23(a)-6, *Reg. 86* (1934), Art. 23(a)-6, *Reg. 101* (1938), Sec. 19.23(a)-6, *Reg. 103* (1940), and Sec. 29.23(a)-6, *Reg. 111* (1941 to date).

The foregoing histories, including the fact that the administrative interpretation antedated the specific statutory provision, emphasize the logic and reason for the application to the question at issue of the established principle that a consistent and longstanding administrative interpretation of a statutory provision, reenacted without change, must be presumed to conform to the legislative intent, and must be given the force and effect of law. *Crane v. Commissioner of Internal Revenue*, 331 U. S. 1, 91 L. Ed. 931, 67 S. Ct. 1047; *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 83 L. Ed. 536, 59 S. Ct. 423; *White, et al., Executors v. United States*, 305 U. S. 281, 83 L. Ed. 172, 59 S. Ct. 179; *Helvering v. Winmill*, 305 U. S. 79, 83 L. Ed. 52, 59 S. Ct. 45; *United States v. Dakota-Montana Oil Company*, 288 U. S. 459, 77 L. Ed. 893, 53 S. Ct. 435; *Commissioner of Internal Revenue v. West Production Co.* (9 Cir.), 121 F. 2d 9.

The Petitioner, therefore, respectfully submits the following as the controlling principle in the decision of the question at issue:

Sec. 29.23(a)-6 of *Regulations 111* has the force and effect of law. Said regulation unequivocally states the following (*italics supplied*):

“(3) In any event the allowance for the compensation paid may not exceed what is reasonable un-

der all the circumstances. . . . *The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.*”

As the Petitioner has shown in the preceding division of this brief, the record in this proceeding clearly warrants the conclusion that the Hoffman employment contract was the result of a free bargain, and was fair and reasonable in the light of the circumstances attending its execution. It follows, therefore, that the compensation paid by Petitioner to Hoffman in 1943 pursuant to the December 4, 1941, employment contract must be allowed as a deduction since the controlling circumstances governing reasonableness are “those existing at the date when the contract for services was made.”

It is apparent from the Tax Court opinion that a prime source of the Tax Court’s error in this case lies in its studied disregard of the underlined language in the regulation quoted above. For example, the Tax Court opinion [R. 42] states as follows:

“Section 29.23(a)-6(3) provides that ‘In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances.’ The remaining portion of the section does not alter the conclusion that the amount paid must be reasonable.”

True the remaining portion of the regulation does not alter the conclusion that the amount paid must be reasonable, but said remaining portion states unequivocally that the circumstances to be considered in determining reasonableness are “those existing at the date when the contract for services was made”; yet the Tax Court

ignored this important provision. Again, in discussing the case of *Austin et al. v. United States* (5 Cir.), 28 F. 2d 677, the Tax Court [R. 42-43] lightly dismissed the case as “stating generally that it is immaterial that the actual working out of a contract may prove greater than the amount ordinarily paid”; whereas in fact the *Austin* case specifically decided (28 F. 2d at 678) that contingent compensation paid pursuant to a contract which “Under normal conditions, doubtless . . . would have been unreasonable,” must be allowed as a deduction because “The reasonableness of the contract is to be viewed in the light of the circumstances that existed when it was made.” It is difficult to understand why the Tax Court ignored this language of the *Austin* case, for it is not a dictum but is the basis of decision in that case, and it has an obvious bearing on the present inquiry. In fact, the attitude of the Tax Court on this point is not a little disquieting when contrasted with the opinion of the same Tax Court Judge dealing with the same issue in a case heard by the Judge on the same calendar as that in which this Proceeding was heard. That is, in the case of *California Vegetable Concentrates, Inc.* (June 23, 1948), 10 T. C. 1158 (No. 150), one issue was the reasonableness of deductions paid officer-stockholders in the form of fixed salaries plus contingent compensation of from 25 to 35 per cent of the net profits. Judge Disney upheld the deductions, and in the course of his opinion he stated the following:

“The Treasury Regulations approve broadly the method employed by petitioner to fix the amount of the compensation in question (quoting subdivisions (2) and (3) of *Reg. 111*, Sec. 29.23(a)-6).”

“The arrangements disclose a fixed policy of petitioner to pay its key officers compensation based, in

part, upon net profits. It has been held that such a policy 'is based primarily upon sound business principles', *Gray & Co. v. United States*, 35 F. (2d) 968. In *Austin v. United States*, 28 F. (2d) 677, the Court said that 'The reasonableness of the contract is to be viewed in the light of the circumstances that existed when it was made' and 'It is immaterial that in the actual working out of the contract contingent compensation may prove to be greater than the amount which ordinarily would be paid.' "

Are we to understand then that on June 23, 1948, the cited regulation, the *Austin* case, and the *Gray & Co.* case are to be regarded as compelling precedents in the decision of a reasonable compensation issue (10 T. C. 1158, No. 150), whereas six days later the same precedents can be lightly dismissed by the same judge as inapplicable to a decision on the same issue? [R. 42-43.]

The *Austin* case (28 F. 2d 677) is material to the present inquiry for additional reasons. The case was decided under the *Revenue Act of 1918* (40 Stat. 1077) which, as previously developed herein, was the first revenue act to specifically provide for the deduction of a "reasonable allowance for salaries or other compensation," and the court cited and relied upon the administrative regulation (*Reg. 65*, Art. 106, a predecessor of *Reg. 111*, Sec. 29.23(a)-6) in deciding the case. Further, the circumstances which impressed the court as indicating the initial and controlling reasonableness of the contingent compensation contract there involved were that (28 F. 2d at 678) "When the contract for salaries was entered into, the corporation was financially unable to continue in business. What it did was practically to give up its business because of its inability to carry it on." It is submitted that these circumstances find a close parallel in the record in

this matter for, as the Petitioner has developed in the preceding division of this brief, at the time the Hoffman contingent compensation contract was executed on December 4, 1941, the Petitioner's physical plant and inventory were obsolete and in sorry shape; it had no production staff and its production activities were at a standstill; there was internal dissention in its management; it was in financial difficulties; it had a poor reputation in the radio industry; it had lost its principal sales account and had no firm future prospects; it was delinquent in its payment of salary to its then president; and it was in no position to employ Hoffman on a fixed compensation basis. [R. 22-25, 31, 33, 44, 68-71, 76-77, 80, 83, 130-132, 134-136, 164-165, 178, 193-195, 200, 213-214, 235, 246, 270-271, 275-277, 278-281, 348-349, 490, 499, 507-508, 521, 527-530.] The Tax Court admitted [R. 44-45] that "petitioner's business activities were in poor condition at the time Hoffman closed the negotiations for acquiring stock and management control of it and a great part of the success of the venture was due to his efforts"; yet it failed to give effect to this circumstance because of its obvious disregard, in this case, of the principle that the reasonableness of a compensation payment made pursuant to a pre-existing contract is to be judged in the light of the circumstances existing at the time the contract was entered into.

Your Honorable Court, in the case of *Harvey v. Commissioner of Internal Revenue* (9 Cir.), 171 F. 2d 952, has indicated adherence to the principle here contended for by the Petitioner. The *Harvey* case, among other points, involved the deductibility of a contingent fee paid by a father to his son, an attorney. There the taxpayer, relying on an alleged contract with his son, failed to introduce evidence of the value of the son's actual services, and

your Honorable Court, upon sustaining the conclusion of the Tax Court that the contract was not a bona fide one, remanded the case to permit the introduction of evidence of the value of the services rendered, and stated the following (171 F. 2d at 955; italics supplied):

“The Tax Court held the contract ineffective insofar as the tax situation was concerned. *The petitioner, relying on the contract, was not called upon to produce evidence of the reasonable value of the services rendered.* The alleged contract being held ineffective he should have the opportunity to submit such evidence, and the case should be reopened for that purpose.”

In other words, as the Petitioner understands your ruling, if a contract for services is a reasonable and valid one in the light of the circumstances attending its execution, the taxpayer's burden of going forward, and the judicial scrutiny, stops at that point; and only in the event that the preexisting contract is found wanting need the taxpayer and the court inquire into the events which subsequently occur in the working out of the contract. In view of this principle, which is the same as that set forth in the controlling regulation, quoted above, and in the *Austin* case (28 F. 2d 677), the Petitioner respectfully submits that it is entitled to judgment in this proceeding, since the record clearly shows that the Hoffman contingent compensation contract was a fair and reasonable one in the light of the circumstances existing on December 4, 1941, the date of its execution.

IV.

The Compensation Paid by Petitioner in 1943 to H. L. Hoffman, Its President and General Manager, Was Reasonable in Relation to the Services Actually Rendered by Hoffman.

While the Petitioner respectfully submits that the judicial scrutiny of the compensation deduction at issue should cease upon being satisfied that the December 4, 1941, contingent compensation contract between Petitioner and H. L. Hoffman was the result of a free bargain, and was a reasonable contract in the light of the circumstances attending its execution; yet, if further review is considered necessary, the record in this proceeding clearly demonstrates that the compensation paid for the year at issue was reasonable in relation to the services rendered by Hoffman.

The salient factor to consider is that under the presidency and general managership of Hoffman, the Petitioner progressed in the short space of the years 1942 and 1943 from an insolvent company, with inadequate and obsolete equipment, no production staff, and a bad reputation in the industry [R. 22-25, 31, 33, 44, 68-71, 76-77, 80, 83, 130-132, 134-136, 164-165, 178, 193-195, 200, 213-214, 235, 246, 270-271, 275-277, 278-281, 348-349, 490, 499, 507-508, 521, 527-530] to a prosperous going concern with modern equipment and a staff of 297 employees, successfully engaged in the production of the most exacting type of precision instruments, and it had become one of the key prime war contractors for the Navy, and it was the only West Coast contractor in the electronics field to be recommended for the Army-Navy E award. [R. 23-25, 33-34, 35-36, 84-94, 346-390, 95-100, 391, 392-393, 100-105, 106-108, 153-163, 167-168, 170-

172, 173-174, 184-185, 202-203, 215-227, 229-236, 257-259, 264-265, 485 (Section XVIII), 549.] It is material to note that the Tax Court found [R. 45] “that a great part of the success of the venture was due to his (Hoffman’s) efforts,” and counsel for the Respondent conceded that Hoffman was “undoubtedly one of the main motivating factors in the organization.” [R. 55.] It is submitted that since admittedly a great part of Petitioner’s success was due to Hoffman’s efforts, it was not unreasonable to compensate Hoffman in relation to that success, pursuant to a preexisting and binding contingent compensation contract. As the court stated in the case of *William S. Gray & Co. v. United States* (Ct. Cls.), 35 F. 2d 968 at 974—

“Every business is largely dependent upon the capacity, resourcefulness, and assiduity which its executive officers give to it”

and the court sagely pointed out that—

“The policy of agreeing to pay a percentage of the earnings before they are earned, or even a sum in the nature of a bonus after they are earned, is based primarily upon sound business principles. It stimulates the activity, diligence, and ambition of the employees in the case of a percentage of the profits, and in both the case of a percentage and of a bonus it enables the corporation to justly compensate its employees without beforehand incurring the obligation. . . . If the profits were small, the sum realized from the percentage was small, and if the profits were large, the sum so realized was larger, depending in each year upon the loyalty, vigilance, and intelligent effort, and the stimulated ambition of each of the parties. . . .”

Further, the Respondent's own *Regulations 111*, Section 29.23(a)-6(2) (which, as previously developed herein, has acquired the force and effect of law) states that—

“Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration upon the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.”

That is, the regulation sets up a general rule that contingent compensation may well exceed the amount which might be paid as fixed flat rate compensation and still be classed as reasonable.

During the year at issue, 1943, the Petitioner had only three active executive officers, including H. L. Hoffman. [R. 485, Sec. XVI, 545, 34.] Hoffman was the President and General Manager of the Petitioner; he was its only salesman and business solicitor, and he obtained war contract orders in the amount of \$4,382,050.13 in 1942 and \$888,244.81 in 1943; he was in charge of personnel; he handled advertising and public relations work; he was coordinator of production; he performed the work usually performed by a Washington representative; he was instrumental in organizing, and was the first president of, the West Coast Electronics Manufacturers Association, which organization contributed substantially in helping smaller companies, including Petitioner, to secure war contracts; he negotiated the bank financing necessary to obtain working capital for the Petitioner, and, together

with Mr. Davidge and Mr. Douglas, he personally guaranteed the bank loans; he, together with Mr. Davidge and Mr. Douglas, advanced funds to the Petitioner to enable it to make the down payment on its major asset, a plant needed to handle its Navy frequency meter contract; he participated in making technical decisions on the feasibility or non-feasibility of submitting bids on various types of contracts; and he worked a fourteen to sixteen hour day. [R. 34, 35-36, 80, 84-92, 100-101, 106-108, 157-158, 161-162, 264-265, 346-393.] In the face of this record, it shouldn't be necessary to state that Hoffman worked hard and rendered valuable services during 1943, yet the Tax Court apparently reached the contrary conclusion for it stated the following [R. 45]:

“There is no indication that his services that year (1943) were of any greater value than the year before when he received a substantially smaller salary and bonus. In fact, the contrary may be true since he obtained war contract orders in the amount of \$4,382,050.13 in 1942 and in the amount of only \$888,244.81 in 1943.”

The errors in the Tax Court's reasoning on this point are glaring. In the first place, business solicitation was only one of Hoffman's manifold duties, see above. Secondly, it should have been clear to the Tax Court that orders, once obtained, have to be translated into production and delivery, and since the Petitioner's net sales in 1942 and 1943 were \$351,950.62 and \$1,787,850.14 [R. 23] it is obvious that it was working on the 1942 orders in 1943 and later years. In this connection, the Tax Court found as a fact that “Production and delivery under the orders obtained in any one year was not necessarily limited to the year in which the order was obtained” [R. 35-36],

yet it failed to give effect to this finding in evaluating Hoffman's services in 1943. The record shows that Petitioner's 1943 sales volume increased 689% over 1942, and its personnel expanded 177% [R. 373, 377-378], and since Hoffman was coordinator of production, in charge of personnel, etc., it should have been clear to the Tax Court that his duties necessarily increased in 1943. Other Tax Court judges presume an increase in duties and responsibilities from an expansion of production; for example, see the opinion of Judge Le Mire in *Chandler Products Corporation*, Tax Court Memorandum Decision entered September 23, 1948, Docket No. 13990, Commerce Clearing House Tax Court Reporter Decision 16,596(M):

“While its large increase in business in 1941 and 1942 was due to the war, it undoubtedly resulted in an increase in the duties and responsibilities of the officers.”

It is also interesting to note the comment of Judge Disney, the Judge below, in the case of *California Vegetable Concentrates, Inc.*, 10 T. C. 1158, No. 150, to which detailed reference has been made in the preceding division of this brief. In the *California Vegetable* case Judge Disney reasoned that “The large profits in the taxable years were made possible to a large extent by the effort expended by Sims and Pordieck in prior and less profitable years”; yet in the case of this Petitioner the same Judge ignored this factor. As a final comment on this phase of the Tax Court's error, it is clear that since Hoffman's contingent compensation was geared to sales and not to orders, and since the 1943 sales were greater than the 1942 sales [R. 23], the necessarily smaller compensation paid to Hoffman in 1942 is not, as the Tax Court appears to have reasoned, a precedent for restricting the amount of Hoffman's 1943 compensation.

The Petitioner submits that the action of the war contracts renegotiation authorities in accepting as reasonable the compensation paid by Petitioner to Hoffman in 1943 [R. 104-105] is material to the issue under review, since it represents the considered judgment of an arm of the Federal government equal in importance to the Respondent in a matter that was of special concern to the renegotiators. The *Renegotiation Act of 1943* (Act of April 28, 1942, Section 403(a), Sixth Supplemental National Defense Appropriation Act, 1942, Public Law No. 528, 77th Congress, 2d. Session, as amended by Act of February 25, 1944, Section 701(b) of Revenue Act of 1943, Public Law No. 235, 78th Congress, 2d. Session) provided in part as follows:

“In determining excessive profits there shall be taken into consideration the following factors:
. . . (ii) reasonableness of costs and profits . . .”

“Irrespective of the method employed or prescribed for determining such costs, no item of cost shall be charged to any contract . . . or used in any manner for the purpose of determining such cost, to the extent that in the opinion of the Board . . . such item is unreasonable. . . . Notwithstanding any other provisions of this section, all items estimated to be allowed as deductions and exclusions under Chapters 1 and 2E of the Internal Revenue Code (excluding taxes measured by income) shall . . . be allowed as items of cost . . .”

Chapter 1 of the *Internal Revenue Code*, referred to in the last quotation, covers Section 23(a)(1)(A), the statutory provision involved in this proceeding; hence, the applicability of this provision to the 1943 Hoffman compensation was necessarily considered by the renegotiation board; and this is made clear by the Renegotiation Regulations, pro-

mulgated on March 24, 1944, by the War Contracts Price Adjustment Board. *Renegotiation Regulations* Section 381.4(3) provides in part as follows:

“The Act requires the War Contracts Board to allow as items of cost . . . all items estimated to be allowable as deductions and exclusions under Chapters 1 and 2E of the Internal Revenue Code. . . . However, the Act does not require the allowance of items as costs merely because they have been or are expected to be allowed for tax purposes by particular revenue agents or other representatives of the Bureau of Internal Revenue. Occasionally cases may be encountered where revenue agents have allowed salaries or other items as deductions for tax purposes which the renegotiating agency concludes are not properly allowable under the Internal Revenue Code or are properly allowable in a different amount. In such cases the action of the revenue agents need not be regarded as conclusive. The renegotiating agency may and should exercise independent judgment as to whether and to what extent the items are allowable as deductions or exclusions under the Internal Revenue Code. Such judgment should be based upon an estimate of what the courts would do if the deductibility or excludibility of the item were the subject of litigation.”

The Petitioner contends that the act of the war contract renegotiating board in accepting the 1943 Hoffman compensation as a proper element of cost [R. 104-105] is strong and impartial evidence of the reasonableness of that compensation under the provision of the *Internal Revenue Code* involved herein. Further impartial evidence along this line is the fact that the California Bank and the Federal Reserve Bank of San Francisco placed no

restriction on the payment of the Hoffman contingent compensation in the Loan Agreement executed July 10, 1943, and the Guarantee Agreement executed September 8, 1943. [R. 394-413.] Paragraph 6 of the Loan Agreement [R. 405-407] provides in part as follows:

“6. While any of the revolving credit granted to the Borrower under this Agreement is in use or available to it and so long as any of the notes evidencing loans under this Agreement are unpaid the Borrower agrees that:

(a) Without the prior written consent of the Bank and the prior written consent of the Federal Reserve Bank of San Francisco . . . the Borrower will not . . . (iv) Declare or pay any cash dividends upon its capital stock . . . ; . . . (viii) Permit Borrower’s officers and/or directors to withdraw more than the aggregate sum of \$1,500.00 cash per calendar month as salaries, or to make any cash payments to Borrower’s officers or directors as fees, bonuses or otherwise *except pursuant to agreements which were already in effect on January 1, 1943;*” (italics supplied).

It is logical to assume that if either the lender bank or the guarantor Federal Reserve Bank had believed that the Hoffman contingent compensation contract for 1943 was unreasonable, a definite restriction would have been placed on payments by Petitioner to Hoffman; but in fact both institutions accepted the contract as a reasonable one.

Other evidence that the 1943 Hoffman compensation was reasonable appears in the record. Hoffman’s contingent compensation was at the rate of 3% of sales. He was the Petitioner’s only salesman and business solicitor

[R. 35] in addition to his other onerous duties as President and General Manager of Petitioner (see above); and it was not uncommon in the year at issue to pay business solicitors commissions of 3% and 5% on business obtained. [R. 101-102, 182-183, 195.] Further, the Respondent put on the testimony of S. W. Gilfillan [R. 297-342] for the stated purpose of setting up a comparative standard of reasonableness [R. 320-321]; yet judged by the Respondent's own comparative (Gilfillan Bros., Inc.), the Petitioner makes the more favorable showing, as follows:

Ratio of General and Administrative
Expenses to Net Sales

	Gilfillan Bros., Inc.	Petitioner
Before renegotiation	8.47%	6.36%
After renegotiation	8.73%	6.54%

[R. 479, 358, 530, 23, 38.]

That is, even though the net sales of Gilfillan Bros., Inc. were approximately two times those of Petitioner, and even though it generally follows that the ratio of general and administrative expenses decreases in amount as sales increase, yet the Petitioner's general and administrative expenses (including the compensation of H. L. Hoffman) were considerably a lesser percentage of its smaller net sales than was true in the case of the Respondent's comparative. This is convincing proof that the compensation paid by Petitioner to Hoffman was reasonable, in that it did not inflate general and administrative expenses in relation to sales. Further proof of the reasonableness of the Petitioner's compensation payments is found in the fact that Petitioner netted a greater percentage of profits (profits *after salaries* and renegotiation, and before Fed-

eral taxes) than did the Respondent's comparative. That is, the Petitioner's Net Profit Before Federal Taxes of \$171,432.94 represents a net profit of 9.59% of its net sales, whereas the Gilfillan Bros., Inc.'s Net Profit Before Federal Taxes of \$306,949.64 represents a net profit of only 8.78% of its net sales. [R. 23, 38, 479-480, 530.] Certainly if the compensation paid by Petitioner to Hoffman had been unreasonably inflated, it would not have netted a greater percentage of profit than the profit of the Respondent's comparative.

It is, perhaps, stressing the obvious to point out that in the proceeding at issue there was no element of "milking" the corporation to pay the salary of a favored officer-stockholder. Even after the payment of salaries, the Petitioner realized a net profit before taxes of \$171,432.94 which represented a return of over 100% on its capital accounts, the latter consisting of Preferred Stock, \$72,500.00, Common Stock, \$41,300.00, and Paid-in Surplus, \$10,373.71, or a total capital of \$124,173.71. [R. 528.] Further, even after the payment of salaries (and even if the Petitioner is wholly successful in this proceeding) its taxable income will be such that will pay approximately \$156,215.74 in Federal income and excess profits taxes. [R. 9-19.] The Petitioner submits, and the Tax Court so found [R. 45] "that a great part of the success of the venture was due to his (Hoffman's) efforts"; and that the Petitioner's compensation payments to Hoffman were not only reasonable but are proof of the fact (stated in the case of *William S. Gray & Co. v. United States* (Ct. Cls.), 35 F. 2d 968 at 974) that "The policy of agreeing to pay a percentage of the earnings before they are earned . . . is based primarily upon sound business principles. It stimulates the activity, diligence, and ambition of the employees . . . and . . . it

enables the corporation to justly compensate its employees without beforehand incurring the obligation.”

The Petitioner may be in error on the point, but it cannot help but feel that its case was ill-received before the Tax Court because 99.96% of its 1943 sales related to war orders. This feeling doubtless finds its origin in the contrast between the Tax Court decision in this case, and the decision in the case of *California Vegetable Concentrates, Inc.*, 10 T. C. 1158, No. 150, to which reference has been made above in two divisions of this brief, and in the remark of the Court [R. 45] that “In 1943 petitioner did an unusually large amount of business, attributable in the main . . . to war conditions of the year.” The Petitioner might feel selfconscious about this point were it not for the fact that war conditions brought an abrupt halt to its budding peacetime business [R. 22, 481-482, Sec. III, 486-487]; and for the fact that it made a substantial and valuable contribution to the war efforts [R. 34, 36, 53, 184-185, 202-203]; and for the further fact that the war contracts renegotiation board approved its compensation arrangements; see above. That is, the peacetime operations of the Petitioner were devoted to the manufacture of home radios. After H. L. Hoffman took over the presidency and general management of the Petitioner, and starting from scratch on January 1, 1942, it manufactured and sold, in less than a year, some \$122,799.03 in commercial radios [R. 488], in contrast to sales of only \$29,763.82 for the year prior to Hoffman’s employment. [R. 23.] The peacetime business of Petitioner was early in 1942 brought to a close by a general order of the War Production Board, issued March 7, 1942, and effective April 23, 1942, which restricted and finally prohibited the commercial manufacture of radio receivers. [R. 22, 486-487.] Thus the Petitioner was faced

with a Hobson's choice of oblivion or going into war production. War orders were not easily obtainable in the electronics field because (1) the Petitioner, located in Los Angeles, California, was in a "number one critical labor area"; that is, an area classified as one in which a critical labor shortage existed and in which war orders were to be restricted to airplane manufacture and shipbuilding and to the exclusion of other war orders [R. 34, 91, 106-107]; (2) Army and Navy procurement offices, located in the East, regarded the West Coast as an invasion zone [R. 91]; and (3) Army and Navy procurement officers had to be convinced that West Coast industry could manufacture and supply component parts. [R. 90-91, 106-107.] In spite of these obstacles, Hoffman was successful in obtaining substantial war orders for the Petitioner. [R. 34, 35.] The type of war contracts obtained and performed by the Petitioner were not those involving simple, mass-scale assembly work, but, on the contrary, as the Tax Court found [R. 36], they required the exercise of managerial, engineering, and mechanical skill and inventiveness in design, production, procedures, tooling, testing equipment, and the efficient use of, or substitution for, materials which were critically short in supply; and many of the orders were not of the type solicited by comparable companies, or they were orders in the performance of which other companies had failed. [R. 36, 184.] The Petitioner successfully and efficiently performed its war effort, and it was the only West Coast company in the electronics field to receive the Army-Navy E award from the Navy. [R. 34, 102.] James M. Tuttle, a witness at the hearing, who had been a Navy lieutenant and the assistant head of the production department of the electronics division of the Bureau of Ships, Navy Department, and who stated that he learned at first hand the capabilities

and facilities of all radio manufacturers in the United States, testified that the Petitioner earned a reputation with the Navy Department to such an extent that it became a key prime contractor for the Navy. [R. 202-203.]

The Petitioner is proud of its war record, and it submits that that record should not be classed as a detrimental factor in this proceeding. As the court stated in the case of *Roth Office Equipment Company v. Gallagher* (6 Cir., Feb. 10, 1949), 172 F. 2d 456, "While economic conditions brought on by the war is a factor to be considered in these cases, the Tax Court has held several times that this alone does not establish unreasonableness where war business has resulted in increased work and responsibility (citing cases)." See also *Chandler Products Corporation*, Tax Court Memorandum Decision, Docket No. 13990, September 23, 1948, Commerce Clearing House Tax Court Reporter, Decision 16,596M; *Elbert Steel Corporation*, Tax Court Memorandum Decision, Docket No. 4401, May 21, 1945, Commerce Clearing House Tax Court Reporter, Decision 14,576(M). The fact that war conditions resulted in increased work and responsibility for the Petitioner and Hoffman is apparent from the record, and has been developed at length hereinabove; and in the light of this fact, the *Roth* case, *supra*, establishes the rule that economic conditions brought on by the war are not a factor in establishing unreasonableness of compensation paid in the form of bonuses, much less compensation paid pursuant to a preexisting, binding contingent compensation contract.

Conclusion.

The Petitioner contends that the Tax Court clearly erred in not allowing the Petitioner a deduction for the entire \$63,613.20 compensation paid by it to H. L. Hoffman in 1943, and the decision should be reversed on this point.

Los Angeles, California, April 11, 1949.

Respectfully submitted,

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APPENDIX.

STATUTES.

INTERNAL REVENUE CODE, SECTION 23(a)(1)(A).

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

REVENUE ACT OF 1916 (ACT OF SEPT. 8, 1916, 39 STAT. 756), AS AMENDED, SEC. 12(a).

Sec. 12(a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, * * *

UNITED STATES TREASURY DEPARTMENT REGULATIONS.
REGULATIONS 111, SEC. 29.23(a)-6.

Sec. 29.23(a)-6. Compensation For Personal Services. —Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (a) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (b) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries

of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

TREASURY DECISIONS.

TREASURY DECISION 2696, VOL. 20, TREASURY DECISIONS
(GOVERNMENT PRINTING OFFICE, 1919), PAGE 330.

Treasury Department
Office of Commissioner of Internal Revenue
Washington, D. C.

To collectors of internal revenue and others concerned:

Section 5(a) of the income-tax act of September 8, 1916, as amended, provides, as to the income of individuals and partnerships, that for the purpose of the tax there shall be allowed as deductions, among others, "the necessary expenses actually paid in carrying on any business or trade," and section 12(a) provides that the net income of a corporation shall be ascertained by deducting from the gross amount of its income received within the year, among other things, "all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties."

Payments for services by business enterprises (including individuals in business, partnerships, and corporations) may, of course, be deducted under this general language. The Government, entitled to taxes based on the net income of each enterprise, is interested and authorized, however, to see that each specific expenditure sought to be deducted is in itself "necessary." The question is by what examination and what test this shall be determined. The subject is not dealt with in any general way in the income-tax regulations, although article 138 bears on special payments to employees of corporations.

The test of deductibility in the case of compensation payments is whether they are in fact payments purely for

services or include some other element. But in the case of any compensation, however determined, which exceeds amounts ordinarily paid for like services in like enterprises under like circumstances, the burden is upon the enterprise to show that the amount paid was solely the purchase price of services. This test and its practical application may be further stated and illustrated as follows:

1. Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible.

(a) An ostensible salary may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few stockholders, practically all of whom draw salaries. If in such a case the salaries are based upon or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries, if in excess of those ordinarily paid for similar services, are not paid wholly for services rendered, but in part as a distribution of earnings upon the stock.

(b) An ostensible salary paid by a corporation may be in part a waste or appropriation of assets of the corporation. This may occur where salaried employees are in control of the corporation through holding directly or indirectly a majority of its stock or, in the case of a large corporation with many stockholders, owning a substantial minority of its stock, and the tendency of the officers unduly to inflate their salaries must be taken into account. If a compensation contract with the majority stockholder or stockholders is approved by all the stockholders, as well as by the directors, it might, however, be dealt with like any other contract.

(c) An ostensible salary may be in part payment for property. * * *

2. The form or method of fixing compensation is not decisive as to deductibility.

While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the enterprise and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

3. As to compensation determined after services have been rendered, reasonableness is ordinarily the controlling test of deductibility.

In certain instances apparently of this sort it may be shown that the compensation is fixed according to a custom or practice having virtually the force of a contract. Where, however, such is not the case and it is for the management to fix compensation such as is deemed fair, it is just to assume that true compensation is only such amount as would ordinarily be paid in like circumstances by other similar enterprises.

The foregoing rules naturally do not permit a ready determination of every question arising as to compensation payments, but applied in the light of full knowledge of the facts in the particular case they do, however, indicate a basis of solution. They may be summed up as follows:

Compensation on whatever basis fixed, representing only the price paid for services pursuant to a fair bargain made in advance between the individual and the business enterprise, is deductible in determining the taxable net income of the enterprise. Payments nominally as compensation for services, which in fact include amounts paid as dividends, waste of corporate assets, payments for property or for anything other than services, are deductible only to an amount not in excess of compensation for like services in similar enterprises.

Compensation greater than that ordinarily paid for like services in similar enterprises must be shown to represent payment for services only. In the case of compensation fixed after services are rendered and not in accordance with any contract or any custom or practice amounting virtually to a contract, reasonableness is ordinarily the controlling test of deductibility.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

Approved April 10, 1918:

R. C. LEFFINGWELL,

Acting Secretary of the Treasury.

No. 12144

In the United States Court of Appeals
for the Ninth Circuit

HOFFMAN RADIO CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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FILED

APR 11 1949

U.S. DEPARTMENT OF JUSTICE
OFFICE OF THE ATTORNEY GENERAL



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*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 21-46) are unreported.

JURISDICTION

This petition for review (R. 551-555) involves federal income, declared value excess profits, and excess profits taxes for the taxable year 1943. On May 9, 1946, the Commissioner of Internal Revenue mailed to the taxpayer notice of deficiency in the total amount of \$55,945.35. (R. 9-19.) Within 90 days thereafter and on July 31, 1946, the taxpayer filed a petition with the Tax Court for a redetermination of that deficiency

under the provisions of Section 272 of the Internal Revenue Code. (R. 4-8.) The decision of the Tax Court modifying the deficiency was entered September 22, 1948. (R. 47.) The case is brought to this Court by a petition for review filed November 30, 1948 (551-555), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court properly determined the maximum reasonable amount that may be claimed for salary expenses under Section 23 (a) (1) (A) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations involved are to be found in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court may be summarized as follows:

Taxpayer, a California corporation, was incorporated in 1932 under the name of Mission Bell Radio Mfg. Co. Its name was changed in 1943 to Hoffman Radio Corp., without altering the continuity of its corporate existence. (R. 22.)

From 1932 to 1942, taxpayer was principally engaged in manufacturing commercial radio receiving sets, but this manufacture was restricted and finally prohibited by a general order of the War Production Board issued March 7, 1942, effective April 23, 1942. (R. 486-487.) In 1942 taxpayer was engaged in manufacturing radio and electronic equipment. Sales of commercial radios constituted 31.61 per cent of its total sales; sub-contracts on Government orders constituted 65.24 per cent; experimental work constituted .15 per cent. Its 1943

sales were chiefly related to Government contracts and orders, 99.96 per cent. The remaining .04 per cent related to commercial sales. (R. 22.)

From the date of incorporation to 1941, inclusive, taxpayer's operation was as follows: It sustained net losses in 1932, 1933, 1939, 1940, and 1941; it realized net income in the years 1934 to 1938. (R. 22.) A table of comparative profit and loss statements for the years 1940 through 1943 may be found at pages 23 to 25 of the printed record.

In July of 1941, H. L. Hoffman became interested in acquiring control of taxpayer. He thoroughly investigated its affairs. In October or November of that year, he interested G. Gifford Davidge and Walter D. Douglas in a plan to acquire stock and management control. Davidge and Douglas were both men of ample means, and were conversant with taxpayer's affairs and reputation in the industry. They were both experienced in the radio and electrical business and had experience in the statistical and financial phases of the security investment business. Hoffman was not, and is not now, related to Davidge and Douglas, nor was he acquainted with them when negotiations commenced for the acquisition of taxpayer. (R. 26.)

Evidenced by formal documents subsequently drawn by Davidge's attorney, Hoffman, Davidge and Douglas entered into an agreement concerning terms and procedures for acquiring control of taxpayer. Hoffman was to contract to purchase, on an installment basis, all the stock of taxpayer, and to hold the stock interest so acquired as trustee for himself (50 per cent interest), Davidge, and Douglas (25 per cent each); each of the parties was to become a director and officer of taxpayer; Hoffman was to be employed as general manager at a fixed salary later to be agreed on, plus an incentive compensation in a monthly amount equal to three per cent

of the monthly gross sales; each was to loan capital to the taxpayer, the majority of the lenders to be entitled to determine the use of the money; if at any time any two of the three should determine that taxpayer could not be successfully operated, Hoffman was to make no further payments on the stock and the trust was to terminate. (R. 26-27.)

Prior to December 1, 1941, taxpayer's stockholders were: H. G. Schmieter, 110 shares; Franklyn and Helen E. Warner, 193 shares; P. L. Fleming, 110 shares. (R. 27.)

By separate written agreements of December 1, and December 4, 1941, Hoffman agreed to purchase all 413 shares of outstanding stock, for the sum of \$11,755, to be paid in installments. The December 1 agreement (R. 489-498) between Hoffman and Schmieter ~~was~~ provided in part for Hoffman's employment as general manager, pending payment in 36 months for the stock, to be paid three per cent of taxpayer's gross sales. (R. 27-28.)

Under this agreement, Hoffman was to receive all dividends, except in case of his default. A new certificate for the 110 shares held by Schmieter was to be issued to Hoffman, then endorsed to Schmieter as collateral for payment. (R. 28.)

On December 4, 1941, Hoffman made a substantially similar agreement with the Warners (R. 498-506), except that he was also to receive three per cent of the gross sales each month and in addition such an amount as from time to time might be agreed upon between Hoffman and taxpayer. On the same day, Hoffman entered into an agreement with Fleming (R. 507-517) substantially similar to that with the Warners. Fleming further agreed not to take action against the taxpayer for unpaid back salary until January 15, 1943, at which time a further extension would be agreed upon

provided taxpayer was then unable to pay dividends on its stock aggregating \$1,500. (R. 28-30.)

After Hoffman acquired Schmieter's stock, he became a director. At a directors' meeting December 4, 1941, the directors being Hoffman, Fleming, and one M. E. Penney, Hoffman was employed as general manager of taxpayer, the terms of the agreement being set forth in an instrument dated December 4. (R. 539-541.) The agreement provided for payment to Hoffman of three per cent of all gross sales as partial payment for his services, additional compensation to be paid in "such other amounts as may hereafter from time to time be mutually agreed upon." The agreement was for 36 months, but terminable by Hoffman after February 28, 1942. After the approval of his employment contract, Hoffman advised the board that he had negotiations pending to acquire the remaining stock of taxpayer, a half-hour recess was called, and Hoffman acquired the remaining stock during the recess. The meeting reconvened and upon proper motions, Davidge and Douglas were substituted as directors for Fleming and Penney. (R. 30, 531-535.)

On December 9, 1941, Hoffman, Davidge, and Douglas executed a contract setting forth the agreement of the parties to advance monies to taxpayer; that such parties were to be directors; that Hoffman was to be president and general manager and receive three per cent of gross sales as part compensation; that Davidge was to be vice president, Douglas secretary-treasurer; that Hoffman's stock rights were to be held in trust for the three men, 50 per cent eventually to belong to him, 25 per cent each to Davidge and Douglas. (R. 30-31, 517-525.)

Rather than start a new company, Hoffman, Davidge, and Douglas found it necessary to rehabilitate the old, since its principal asset was a license from R. C. A., one

of the stipulations of which was that it could not be sold or transferred. (R. 31.)

The minutes of a board meeting on May 15, 1942, show discussion of the need for expanded plant facilities, and setting of Hoffman's salary at \$800 per month, among other things. (R. 32-33, 535-538.)

When Hoffman became manager of taxpayer, its physical plant and equipment were small and obsolete. It had no productive staff, the employees consisting of its then president, an office girl, and a stock boy. In 1942 the highest number of employees was 107; in 1943, 297; in 1944, 351. The taxpayer's plant was greatly expanded, from rented quarters of 7,500 square feet in 1941 to a plant area of 40,000 square feet in 1943, including a building bought by taxpayer for approximately \$55,000, the \$25,000 down payment on which was made from funds advanced by Hoffman, Davidge, and Douglas. (R. 33-34.)

Salary and bonus payments and stock ownership of three of taxpayer's officers were as follows (R. 34):

Name and Office	Salary and Bonus 1942	1943	Percentage of Stock Owned
H. L. Hoffman, President and General Manager	\$18,688.52	\$63,613.20	50%
R. A. Yareho, Secretary	2,483.25	5,762.26	None
Walter S. Harmon, Vice Presi- dent and Engineer	7,244.18	22,171.08	None

Taxpayer was located in a number one labor area, which made it difficult to obtain contracts from the Army and Navy. Hoffman was, however, instrumental in forming the West Coast Electronic Manufacturers Association, which contributed substantially in helping smaller companies to secure war contracts. Taxpayer was awarded the Army-Navy E in 1944, on recommendation of the Navy. (R. 34.)

Taxpayer negotiated a loan in September of 1943, the loan agreement providing in part that no further divi-

dends could be paid without the prior consent of the bank. (R. 34, 399-413.)

Hoffman, 38 years of age, held a Bachelor of Arts degree (1928) from Albion College, Michigan, having majored in business administration and philosophy. From 1928 to 1941 he worked with various firms and was also from time to time in business for himself. In 1941 he made \$13,000 per year from the Peerless Electrical Manufacturing Company, paying his own expenses. Previously, his annual income had been considerably lower, showing generally a gradual increase from 1928 on. (R. 35.) During this period he gained experience in practical factory and machine work and methods; supervision of factory production and personnel; merchandising; developing distributor organizations, sales programs, and service organizations; training factory and sales personnel; coordinating sales programs and factory schedules, and salesmanship. Part of his experience was electrical, including radios and fluorescent lighting. (R. 35.)

He was the only salesman and business solicitor employed by taxpayer in 1942 and 1943, obtaining war contract orders of \$4,382,050.13 in 1942, \$881,244.81 in 1943. Production under these contracts was not confined to the year they were obtained. He was also in charge of personnel, and observed a 14-to-16 hour day. Taxpayer had no Washington, D. C., representative in 1942 and 1943. (R. 35-36.)

The type of war contracts obtained and performed by taxpayer in 1942 and 1943 required the exercise of managerial, engineering, and mechanical skill, and inventiveness in design, production, procedures, tooling, testing equipment, and the efficient use of, or substitution for, materials which were critically short in supply. Many of the orders were of a type not solicited by comparable companies, or orders in the performance of

which other companies had failed. The major war products manufactured in these years were frequency meters, variable condensers, antenna kites, phantom antennas, noise peak limiters, and electronic relays and firing error indicators. (R. 36.)

The Continental Radio and Television Corporation, which was succeeded by the Admiral Corporation, was engaged in the business of radio manufacture at Chicago, Illinois. In 1942 it had total net sales of about \$7,500,000, and in 1943 it had total net sales of about \$14,149,513. It had a net profit, after paying salaries and before payment of taxes, for 1943, in the amount of \$1,098,633. All of its 1943 business was from Government orders. The salaries of its officers remained the same in 1943 as they were in 1942, for which years they were substantially as follows: President, \$50,000; vice president, \$35,000; vice president, \$30,000; treasurer, \$18,000; assistant treasurer, \$12,000; secretary, \$15,000; assistant secretary, \$12,000; and Washington representative, \$8,600. Previous to 1942, it had been the habit of this corporation to increase salaries when it had a successful year. But no increase was permitted at this period, "according to law." (R. 37.)

Gilfillan Bros., Inc., was incorporated in 1917, and was in active business in and around Los Angeles. It had been in the business of manufacturing household radios since 1922. It also manufactured electronic equipment, radar and aircraft mechanical parts. In 1941 an estimated 75 per cent of its business was military work and 25 per cent related to commercial radios. At the beginning of 1942 it was manufacturing radios and aircraft precision parts. For the fiscal year ended May 31, 1943, it had net sales after renegotiation in the amount of \$3,495,822.57. It had a net profit, after renegotiation and before payment of taxes, in the amount of \$306,949.64. The salaries of its officers for

this period were as follows: President, \$32,432.40; vice president, \$14,999.92; vice president, \$14,999.92; J. G. Gilfillan (office undesignated) \$10,500; vice president, \$8,400.08; secretary-treasurer, \$4,252.22. (R. 38.)

All of these officers except the vice president, whose salary was \$8,400.08, were stockholders. The salary of the president had remained the same for a period of 15 or 20 years. The salary of its engineers for this period were as follows: Chief engineer, \$15,000; assistant engineer, \$12,000; engineer, \$10,000. Its total number of employees increased in 1943 from 750 to 1,000 at the end of the year. The officers' salaries of Gilfillan Bros., Inc., were "frozen during the war years." (R. 38.)

The Commissioner found that a reasonable allowance for salary for Hoffman for 1943 was \$25,000, rather than \$63,613.20, and that a reasonable allowance for salary for W. S. Harmon, taxpayer's vice president, was \$12,000 instead of \$22,171.08. Accordingly, he assessed a deficiency in income tax, declared value excess profits tax, and excess profits tax for 1943 in the amounts of \$3,279.24, \$1,334.34 and \$51,331.77 respectively. (R. 21.) The Tax Court found that a reasonable salary for Hoffman was \$40,000 and that a reasonable salary for Harmon was \$22,171.08. (R. 21-46.) The reasonability of Harmon's salary is not in issue on this appeal.

The Tax Court reassessed taxpayer's deficiency for the taxable year 1943 as follows: Income tax, \$3,279.24; excess profits tax, \$32,262.38; declared value excess profits tax, none. (R. 47.)

Thereafter, taxpayer petitioned this Court for review of the Tax Court's decision. (R. 551-555.)

SUMMARY OF ARGUMENT

The issue involved must be determined upon the peculiar facts of each individual case and the burden of showing reasonableness is on taxpayer.

Any form of contingent compensation is subject to scrutiny. And where the original contract for contingent compensation is not a fair and free bargain between employer and employee, it is not entitled under the Regulations to permanent protection from scrutiny. In view of the evidence, it can not be said that the taxpayer freely bargained for Hoffman's services. Opinion evidence that the contract was reasonable does not belie this conclusion.

In any event, the Tax Court properly examined into circumstances current in the taxable year, for it can not be said that a contract once reasonable is an open invitation to unreasonable compensation thereunder in later years. Such a conclusion would abrogate the statute. Accordingly, evidence that taxpayer's profits were in great measure increased by the accident of the advent of war, that Hoffman's duties and responsibilities did not increase commensurately with his increase in salary, and that Hoffman's compensation for the taxable year was out of line with the standard shown to prevail in the industry supports the Tax Court's ultimate finding as to a reasonable allowance for Hoffman's salary.

ARGUMENT

I

Considering the Circumstances Under Which It Was Executed, Hoffman's Contingent Compensation Contract Was Not Beyond Scrutiny Under the Regulations

In computing net income subject to income, declared value excess profits, and excess profits taxes, the corporate taxpayer is entitled as a matter of grace to certain deductions from gross income, among them the deduction provided in Section 23 (a) (1) (A) of the Internal Revenue Code (Appendix, *infra*). Therein provision is made for the deduction of the ordinary and necessary expenses paid or incurred in the taxable year in the

carrying on of a business, "including a reasonable allowance for salaries or other compensation for personal services actually rendered." The single issue herein lies in the application of the quoted provision to the facts at bar.

Treasury Regulations 111, Section 29.23 (a)-6 (Appendix, *infra*), provide that the test of deductibility is whether the payments in question are reasonable and are in fact payments purely for services. The Regulations contemplate that employment contracts may embody contingencies which will affect the amounts paid from period to period, and it is implicit that reasonable contingent payments may exceed what would otherwise be a reasonable compensation in given circumstances. But Section 29.23 (a)-6 (3) provides further that—

In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances.

Taxpayer's position is not that the amount of \$63,612.20 rather than \$40,000 is a reasonable salary for Hoffman for the taxable year, but that as a matter of law the full compensation paid him must be allowed as a deduction because it was paid pursuant to a pre-existing contract which was in itself fair and reasonable under the circumstances existing at the time of its execution. Secondly, taxpayer contends that payments to Hoffman represent reasonable compensation even if events subsequent to the execution of the salary contract are to be taken into account.

Taxpayer relies on language in subsection (3) of the pertinent Regulations which provides that—

The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

Upon this language he bases his premise that the full deduction must be allowed as a matter of law. The Tax Court, however, and rightly we believe, considered this language of the Regulations limited by the language of the statute, the statute being of paramount importance and requiring that compensation for any taxable year must in any event satisfy the requirement of reasonability. Accordingly, the Tax Court not only examined the original execution of Hoffman's salary contract as to which it found there was not (R. 44)—

The free bargaining and arm's length transaction, between a corporation and a proposed employee for services on a contingent basis, with which, under the regulation, there should not be interference,

but it also examined the circumstances existing at the time the deduction was sought.¹ The Tax Court held that conditions of the business had radically changed between the time the compensation contract was entered into and the taxable year. The court attributed a large part of taxpayer's greatly increased volume of business to the war emergency and could find no justification for the tremendous increase in Hoffman's compensation for 1943 over 1942.

The Commissioner's position is similar to that expressed in the Tax Court's opinion that (1) the original contract of employment was not the result of a free bargain between employer and individual, and that (2) in any event circumstances present in 1943 did not justify the high salary paid Hoffman.

¹ In this regard the Tax Court did not ignore the ruling of *Austin v. United States*, 28 F. 2d 677 (C.A. 5th), nor its own ruling in *California Vegetable Concentrates, Inc. v. Commissioner*, 10 T. C. 1158, as taxpayer contends. The opinion below is entirely consistent with these two cases.

As Judge Dobie pointed out in *Miller Mfg. Co. v. Commissioner*, 149 F. 2d 421, 423 (C. A. 4th):

It is well settled that the question of what constitutes, for the tax deduction here in issue, reasonable compensation to a specific officer of a corporation, is essentially a question of fact, to be determined by the peculiar facts and circumstances in each particular case. * * * These facts and circumstances vary so widely that each corporate tub must more or less stand upon its own bottom.

Accord: *Miles-Conley Co. v. Commissioner* (C.A. 4th), decided April 2, 1949 (1949 P-H, par. 72,422); *Doernbecher Mfg. Co. v. Commissioner*, 95 F. 2d 296 (C.A. 9th); *Sunset Scavenger Co. v. Commissioner*, 84 F. 2d 454 (C.A. 9th); *General Water Heater Corp. v. Commissioner*, 42 F. 2d 419 (C.A. 9th). It is, moreover, the taxpayer's burden to make out his case by clear and convincing evidence, for the Commissioner's determination as to reasonability is presumptively correct. *Botany Mills v. United States*, 278 U. S. 282; *Patton v. Commissioner*, 168 F. 2d 28 (C.A. 6th); *Clinton Co. v. Commissioner*, 159 F. 2d 102 (C.A. 7th). As it is empowered to do, the Tax Court found the Commissioner's allowance insufficient but the taxpayer's demand too great. Its findings, failing taxpayer's showing that they are clearly erroneous, must stand.

The pertinent provisions of the Regulations subject any form of contingent compensation to scrutiny. Generally—but only generally—a deduction will be allowed for contingent payments if they are made pursuant to a free bargain between the employer and the individual made before the services are rendered, “not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual.” This brand of fair bargain is not present in the case at bar. Admittedly, tax-

payer was hardly in a position to employ Hoffman on a fixed compensation basis in December 1941. Taxpayer was hardly in a position to employ any one, on whatever basis. Admittedly, taxpayer was in poor financial condition, its reputation in the industry bad. Admittedly several witnesses testified that the contingent compensation contract was fair and equitable to the corporation. These facts do not compel the conclusion that here was a free bargain between employer and employee.

In point of fact, the employer never had an opportunity to bargain for itself. Hoffman's bargain for a 50 per cent stock interest, which would give him an appreciable voice in the company, and his bargain for contingent compensation was in effect made before the corporation ever commenced to bargain for his services. Such was his agreement with Douglas and Davidge. It is a fair inference from the evidence that at the time the corporation, through its directors, contracted for Hoffman's employment at the board meeting of December 4, 1941, each director present knew of the pending negotiations by Hoffman to purchase the outstanding stock of taxpayer. The approval of Hoffman's contract by Penney and Fleming therefore has little significance. They knew full well that the taxpayer was about to change hands, apparently upon terms agreeable to all. It would be only natural that Fleming and Penney would go along with Hoffman's plans for the future rather than queer the stock purchase. The Douglas-Davidge ratification of the agreement was no more than their formal approval of the plans they had already made for taxpayer without its knowledge.

Hoffman's contract not only was foisted upon the corporation, but it was clearly a contract formed with his, Davidge's, and Douglas' interests primarily in mind. The taxpayer as a corporation did not enter into

consideration of the bargain. This hardly constituted an arm's length transaction.

Taxpayer lays great emphasis on the testimony of outsiders that the contingent contract was fair and equitable.² This testimony is entitled to consideration by the Tax Court and may not arbitrarily be disregarded for it is relevant, but such evidence is not binding upon the court which may exercise its own independent judgment in determining a reasonable allowance for services. *In re Rae's Estate*, 147 F. 2d 204 (C. A. 3d); *E. Wagner & Son v. Commissioner*, 93 F. 2d 816 (C. A. 9th). These cases are not inconsistent with *Roth Office Equipment Co. v. Gallagher*, 172 F. 2d 452 (C. A. 6th), cited by taxpayer. Taxpayer speaks in its brief as if there were no evidence as to the reasonability of the contingent compensation contract except the testimony of three witnesses. This is not the case. As has been shown, other facts and the inferences to be drawn therefrom contradict these three witnesses, or at least subtract from the weight to be given their testimony. The contract was not entered into pursuant to a free bargain. If it was reasonable at the time, its reasonability was accidental, and in any event it was not such a free bargain as is entitled to permanent protection under the Regulations if any contract would be so entitled.

² Taxpayer stresses the fact that Gilfillan was called originally as a witness for the Commissioner. (Br. 10.) When he testified as to the reasonability of Hoffman's contract, he had been expressly made taxpayer's witness. (R. 322.)

II

In Any Event, the Tax Court Properly Examined the Contract in the Light of Current Facts and Determined Reasonable Compensation, for to Be Deductible Within the Code Compensation Payments Must Be Reasonable Under All the Circumstances

Whether or not the original contract was a fair, equitable, and reasonable one, it could not sanctify Hoffman's compensation in all circumstances. As the Regulations provide, in any event the compensation, to be a deductible expense, must be reasonable under all the circumstances. It is well settled that the Tax Court may take into account in assessing reasonability of compensation the abnormal growth of businesses as a result of our national defense, Lend-Lease, and war programs, and accordingly disallow excessive salaries paid out of those profits. *Locke Machine Co. v. Commissioner*, 168 F. 2d 21 (C. A. 6th), certiorari denied, 335 U. S. 861; *Wood Roadmixer Co. v. Commissioner*, 8 T. C. 247; *Hewitt Rubber Co. v. Commissioner*, decided November 28, 1947 (1947 P-H T. C. Memorandum Decisions, par. 47,317); *Cooked Foods, Inc. v. Commissioner*, decided July 25, 1947 (1947 P-H T. C. Memorandum Decisions, par. 47,223). Cf. *Hecht v. United States*, 54 F. 2d 968 (Ct. Cls.), certiorari denied, 286 U. S. 560.

Even assuming that Hoffman's contract was reasonable at its inception, it is not *carte blanche* to subsequent excessive salary or deduction thereof. Taxpayer acquired no vested right to deduct unreasonable salary payments; prior policy or contract is not conclusive of reasonability. If taxpayer were to be allowed because of long-standing policy to deduct inflated salaries drawn against bloated wartime profits, then the requirement that to be deductible all salary payments must be necessary, ordinary, and reasonable has been abrogated. *Locke Machine Co. v. Commissioner, supra.*

See also *Botany Mills v. United States*, *supra*; *Long Island Drug Co. v. Commissioner*, 111 F. 2d 593 (C. A. 2d), certiorari denied, 311 U. S. 680; *Hecht v. United States*, *supra*. Cf. *Interstate Transit Lines v. Commissioner*, 319 U. S. 590. Necessarily, although more than normal amounts may be paid under a contingent contract, payments can not be allowed beyond reason to absurd lengths.

It is highly material that the advent of the war contributed greatly to taxpayer's business growth. This is readily apparent from the amount of war work it did in 1942 and 1943. There is no indication that Hoffman's work load increased in 1943 commensurately with the salary taxpayer seeks to deduct for him.³ Perhaps the Tax Court can not properly suggest (Cf. R. 45) that contrariwise his work decreased. At any rate the Tax Court did not reach a conclusion contrary to taxpayer's contention that "Hoffman worked hard and rendered valuable services during 1943." (Br. 27.) Hoffman's duties increased administratively in 1943, but this is no indication that they increased greatly over-all. In fact, under military orders administrative work may well have decreased as it did in other firms. (R. 326-327.) Moreover, the court allowed for some increase in Hoffman's duties, such as would necessarily result from a large increase in sales volume, by awarding him \$40,000 which is considerably more than his salary for 1942.

Taxpayer places great reliance upon the conclusion by war contracts renegotiation authorities that Hoffman's compensation was reasonable. (Br. 29.) This conclusion has little value in a tax proceeding. The renegotiation legislation had in mind not an orderly

³ In this connection, it may be noted that long hours and hard work do not of themselves compel a conclusion of reasonability. *Atlas Plaster & Fuel Co. v. Commissioner*, 55 F. 2d 802 (C.A. 6th).

system of providing revenue but its aim was to keep profits and therefore Government costs to a minimum, both to save unnecessary expense to the war program and to forestall snowballing inflation. Moreover, the provisions of the Renegotiation Act cited by taxpayer (Br. 30) specifically state that costs shall not necessarily be allowed because they may be allowed for tax purposes. It follows that the reverse is true. At best, the acceptance of the cost of Hoffman's salary is merely evidence of reasonableness which is not alone sufficient to sustain taxpayer's burden.

In substance, taxpayer argues that because the bank from which it secured a loan did not restrict contingent payments to Hoffman the bank approved them. (Br. 31.) But this thesis is weakened by the bank's insistence on restricting salaries which any officer or director might draw in excess of the contingent payments. Taxpayer's failure to pay dividends may be partially explained by restrictions in the same loan agreement. (Br. 31.) But this does not explain taxpayer's failure to request permission to declare dividends (R. 168-169) nor Hoffman's failure as principal stockholder and trustee for Davidge and Douglas to demand them.

There is no reason for taxpayer to feel self-conscious about the fact that it profited greatly from wartime activity (See Br. 34), nor greatly to stress its nobility of contribution and temporary loss of peacetime business. No one is classifying taxpayer's war record as a "detrimental factor in this proceeding." (Br. 36.) But likewise taxpayer's war record and activity can not be considered an open invitation to abnormal profits, nor abnormal deductions.⁴

⁴ It is not unworthy of note that two Gilfillan employees voluntarily sought flat salary rates of \$15,000 in the face of war profits, when their contingent salary rate would have risen to \$50,000. (R. 338.)

Taxpayer contends that the rule of the *Roth* case, *supra*, is that economic conditions brought on by the war are not a factor in establishing unreasonableness. (Br. 36.) This conclusion is inconsistent with cases cited, *supra*, and with the passages taxpayer quotes from the very same case (Br. 36), to the effect that increased profits due to war activity do not "alone" establish unreasonableness where work and responsibility have increased. But economic conditions indubitably are a factor to be considered in assessing reasonability.

It may be noted in conclusion that the Tax Court's findings with respect to a reasonable salary allowance for Hoffman far more approximate the standard in the industry than the excessive amount taxpayer seeks to claim as a deduction. (R. 37-38.)

CONCLUSION

The decision of the Tax Court is in accordance with law and its findings are not clearly erroneous. Therefore, it should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code:

SEC. 23 [as amended by Sec. 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798].

(a) *Expenses.*—(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23(a)-6. *Compensation for Personal Services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of serv-

ices, is not deductible. (a) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (b) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only

such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

